Supreme Court, U.S.
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No. _____

In The
Supreme Court of the United States

CHARLES T. MADDEN, et al.,

Petitioners,

v.

DELOITTE & TOUCHE LLP,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

When a company sells securities under a registration statement containing audit opinions that are materially misleading when the registration statement becomes effective, Section 11 of the Securities Act of 1933 gives purchasers a remedy in damages against the auditor for resulting losses. Unless the auditor proves that it exercised "due diligence," that the purchasers knew the truth from other sources, or that the purchasers' losses had some other cause, Section 11 imposes absolute liability on the auditor.

The questions presented are:

1. Whether purchasers establish an auditor's liability for material misstatements when the auditor consents to incorporation of its prior audit opinions without investigating or disclosing the company's falsification of earnings and imminent danger of bankruptcy, facts not otherwise disclosed in the total mix of information reasonably made available to the purchasers within the registration statement.

2. If so, whether purchasers establish the auditor's liability for causing the purchasers' losses when public disclosure of the true facts causes a 75% drop in the stock price and the company goes bankrupt within four months of the transaction, in accordance with this Court's recent decision in *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. ___, 125 S. Ct. 1627 (2005).

PARTIES TO THE PROCEEDING

The *PETITIONERS* include the following Plaintiffs and Appellants in the proceedings below: Charles T. Madden; Shashidhar Acharya, M.D.; Achauer Family Limited Partnership, a limited partnership; Angela Allevato, M.D.; Robert A. Baird, M.D.; Annette C. Bernhut-Caplin, D.O.; Thomas W. Broderick, M.D.; Nancy K. Brownell, M.D.; Dawn Lynn Bruner, M.D.; Robert Budman, M.D.; Robert William Buster, M.D.; Michael W. Cater, M.D.; Anna Lisa Chavez, M.D.; Janak R. Chopra, M.D.; Raman Chopra, M.D.; Gaston Cilliani, M.D.; Carmelita R. Co-Casquejo, M.D., F.A.A.P.; William J. Collins, M.D.; Leo H. Cummins, M.D.; Christina K. Elliott; Mark H. Ellis, M.D.; Stanley P. Galant, M.D.; Sherwin A. Gillman, M.D. and Bonnie S. Gillman, as Trustees for the Gillman Community Property Trust; Keith L. Gladstien, M.D.; Stuart M. Gordon; Kenneth E. Grubbs, D.O.; Norah Gutrecht, M.D.; Thomas A. Hryniewicki, M.D.; R. Judd Jessup; Stanley Kanow, M.D.; Leonard Frank Kellogg Jr., M.D.; Mark E. Krugman, M.D.; Lawrence N. Kugelman; Sandra Barry Lieberman; Alan Maderious; Mark C. Marten; William C. McMaster, M.D.; Maria E. Miñon, M.D.; Judith Monge, M.D., as Trustee for the Harrison-Monge 1996 Family Trust; Ronald W. Moreland; Stanley K. Nakamoto, M.D.; Christopher C. Ohman; Kusum Ohri, M.D.; Jack M. Osborn, M.D.; Richard T. Pitts, M.D.; Norman J. Rosen, M.D.; Eric Murrow Rowen, M.D.; Helen Rowen, as Trustee for the Rowen Family Trust Dated May 5, 1982; Mark Steven Rowen; Marshall Rowen, M.D., individually and as Trustee for the Rowen Family Trust Dated May 5, 1982; Scott Jeffrey Rowen, M.D.; Pravin V. Sharma, M.D.; Hal S. Shimazu, M.D.; Sierra Ventures V, L.P., a limited partnership; Aisha

PARTIES TO THE PROCEEDING – Continued

Simjee, M.D.; James B. Tananbaum; Allan G. Weiss; Daniel L. Weissberg, M.D.; Linda F. Weissberg; Laurence D. Wellikson, M.D.; Angela F. Wintheiser, M.D.; and Allan Wong, M.D.

The *RESPONDENT* is Deloitte & Touche LLP, a limited liability partnership, Defendant and Appellee below.

Defendants Steven M. Lash, Seth Flam, Stephen J. Dresnick, and James A. Lebovitz did not participate in the proceedings on appeal. Defendant-Appellee Volpe Brown Whelan & Company, LLC participated in the proceedings on appeal but is not named as a respondent because it has no interest in the outcome of this petition.

The following Plaintiffs participated in a separate lawsuit against the same Defendants and in the appellate proceedings against Deloitte & Touche LLP, but are not parties to this petition and have no interest in its outcome: Navin P. Amin; Ragnar N. Amlie; Choong H. Baick; Lawrence S. Barnett; Marjorie A. Baughan; Birbal Bhaskar; Bharat K. Bhimani; Jonathan Blair; Richard A. Bond; Daniel J. Boyce; Lourdes O. Brown; Alan R. Bures; Raymond J. Casciari; Kim James Charney; Philip Chiu; Allen C. Chou; Paul A. Constantine; W. Lynn Cooper; Theodore Coutsoftides; Joseph K. Cummings; Paul A. Deridder; Constance P. De Silva; Himasiri K. De Silva; Said L. El-Zayat; Meigan Everts; Brian A. Ewald; Mark S. Falcone; Martin J. Feldman; Mario S. Ficarola; Glenn W. Fowler; David W. Furnas; Edward L. Garr; Alan B. Gazzaniga; Leon M. Goldberg; Lisa C. Gorab; Everett P. Grahn; Norman J. Harris; Robert N. Helton; David B. Hertsgaard; David A. Hicks; G. B. Huckaby; Gary Jenkins; John I.

PARTIES TO THE PROCEEDING – Continued

Kleinberg; Bedros H. Kojian; Edward C. Kravitz; D. Sajee Lekawa; Charles T. Levitan; E. Michael Linzey; John B. Luster; G. Gary Mackie; Tariq Mahmood; Paul M. Mansonhing; David A. Margileth; P. Michael McCart; William Metzger; James P. Morley; Michael J. Mullin; Beverly Myers; Sheldon J. Nankin; James A. Padova; Brian A. Palafox; Gregory A. Pecchia; P. Chi Phan; James E. Pierog; John C. Prince; Joseph L. Raffel; Francis H. Rhie; Samuel R. Rosenfeld; Herman L. Rundle; Carl R. Selin; Jeffrey M. Shapiro; Igal Silber; Carole Sofio; Donald R. Sperling; Jack O. Stewart; James J. Strebig; Ivan M. Turpin; Roger H. Wang; Carl R. Weinert; and Jerry D. Wu.

RULE 29.6 CORPORATE DISCLOSURE STATEMENT

No Petitioner is a corporation.

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OPINIONS BELOW

The decision of the Ninth Circuit Court of Appeals is reported at Fed. Sec. L. Rep. (CCH) ¶93,095 (2004) and 118 Fed. Appx. 150 (2004). It appears in the Appendix at 1a. The Ninth Circuit did not select its decision for publication in the Federal Reporter. The District Court's unpublished opinion appears in the Appendix at 9a.

JURISDICTION

The Ninth Circuit filed its decision on November 23, 2004, and denied Petitioners' petition for rehearing on February 4, 2005. App. 1a, 41a. By order dated April 26, 2005, this Court extended the time to file the petition for a writ of certiorari to June 3, 2005. (No. 04A914.) This Court has jurisdiction under 28 U.S.C. § 1254(1) to review the circuit court's decision on a writ of certiorari.

Petitioners filed this action in the Superior Court of California. Respondent and other parties invoked the removal jurisdiction of the district court under 15 U.S.C. §§ 77p(c) and 78bb(f)(2). Dist. Ct. Dkt. 1.[1]

STATUTES INVOLVED

The statutes involved in this case include Section 2, Section 7, and Section 11 of the Securities Act of 1933, codified at 15 U.S.C. §§ 77b, 77g, and 77k. The relevant

[1] This and similar citations refer to entries in the docket of the United States District Court for the Southern District of California that do not appear in the Appendix to this Petition. Nearly all documents filed in this action can be viewed online at http://pacer.casd.uscourts.gov, except certain documents sealed by that court and proceedings prior to a venue transfer from the Central District of California.

parts of these statutes, along with other closely related provisions of securities law, appear in the appendix at 43a.

STATEMENT OF THE CASE

Petitioners, mostly physicians, agreed for FPA Medical Management, Inc. to acquire their $40 million controlling interest in two medical practice groups in exchange for FPA stock newly issued to them under a securities registration statement. Within four months, that stock proved worthless when FPA went bankrupt. Petitioners lost virtually their entire $40 million investment. *See generally* Dist. Ct. Dkt. 84.

The registration statement depicted FPA as a growing company where Petitioners could continue treating the patients of their practice groups, St. Joseph Medical Corporation and Orange Coast Managed Care Services, Inc. The registration statement incorporated verbatim the FPA-St. Joseph-Orange Coast merger agreement, which required FPA to maintain compensation and benefits programs and to optimize accounting, tax, and securities treatment for Petitioners. It warranted that FPA's financial statements conformed to Generally Accepted Accounting Principles and Generally Accepted Auditing Principles (GAAP and GAAS). Petitioners deemed these conditions essential because they would become not simply investors, but also employees and contractors of FPA. Petitioners' medical practices would depend directly on FPA's continued viability. App. 56a-61a, 64a-65a, 84a-95a, 98a-106a; *see generally* App. 50a-110a.

Respondent Deloitte & Touche recertified FPA's latest audited financial statements for incorporation into the registration statement. But the registration statement concealed financial problems that drove FPA bankrupt within four months. In the most recent audit, Respondent

approved two accounting policies relating to certain clinics FPA acquired from Foundation Health Corporation. Respondent approved a revenue recognition policy allowing FPA to recognize over $78 million in fictitious revenue and earnings from 1996 to 1998, distorting FPA's reported earnings by 150% or more. The same policy overstated FPA's "goodwill" asset by at least $78 million. Respondent did not disclose these distortions when it consented to the incorporation of its most recent audit opinions into the registration statement, even though its auditors reviewed the effect of these accounting policies within eleven days of giving that consent and within three days of the SEC order declaring the registration statement effective. App. 10a, 53a-54a, 95a-97a, 108a-110a, 173a-174a, 188a-190a; Dist. Ct. Dkt. 75 at 8-11; Dist. Ct. Dkt. 84 at 36-38 & Exhibit D at 231.

The resulting financial statements violated GAAP and GAAS because they misrepresented FPA's financial condition. FPA used the policies Respondent approved to "manage" its quarterly earnings to beat Wall Street analyst expectations. FPA's chief financial officer knew that public disclosure of this earnings management would destroy the market for FPA stock. App. 144a-150a, 158a-180a, 185a-188a; Dist. Ct. Dkt. 84 at 36-38.

FPA continued to consult closely with Respondent about the revenue recognition policy throughout 1997 and into early 1998. Respondent helped FPA deflect an SEC inquiry into the policy. Several months before the merger, Respondent's auditors internally documented that FPA was "in danger of bankruptcy"; by February 1998, Respondent's ongoing audit work indicated that FPA was rapidly running out of cash. But that month Respondent consented to including its most recent audit opinions as part of the registration statement issued to Petitioners. GAAS required Respondent

to conduct a "subsequent events review" and to qualify or refuse its consent if changes in FPA's financial condition had made its most recent audit opinions misleading, or if Respondent had doubts about FPA's ability to continue at least one year as a "going concern." Respondent issued an unqualified consent and disclosed nothing.[2] App. 127a-132a, 143a-144a, 158a-180a, 188a-190a, 200a-201a, 219a-221a.

The merger proceeded. Petitioners received FPA securities valued at $40 million. Six weeks later, FPA issued a first-quarter report for 1998 that staggered the market. FPA had exhausted the fictitious revenue stream that inflated its earnings. FPA announced earnings 30¢ per share below analyst expectations. FPA also announced that it expected to write down $200 million in balance sheet assets, including $125 million in goodwill, driving its net worth below zero. At least 75% of the goodwill impairment stemmed from the goodwill Respondent approved in the 1996 audit opinion it recertified in February 1998 as part of the registration statement. FPA disclosed that within another six weeks it would run out of cash. In the next two days, the market price for FPA stock fell 75%. Soon FPA declared bankruptcy, driving its stock price down to 12½¢; the merger agreement had valued it at $21.21. Merger-related resale restrictions imposed by the SEC and Nasdaq precluded many Petitioners from selling their FPA securities at any price. The

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[2] The terse wording of the consent belies its importance. "In financial statement auditing, even the most severe circumstances (*e.g.* when a company's capacity to continue as a going concern is in doubt) require virtually no auditor narrative. Rather, auditors can simply cross-reference footnotes to the financial statements so disclosing and indicate that no adjustments to the financial statements have been made." Lawrence A. Cunningham, *Facilitating Auditing's New Early Warning System: Control Disclosure, Auditor Liability, and Safe Harbors,* 55 HASTINGS L.J. 1449, 1475 n.108 (2004).

bankruptcy court wiped out all existing shares. Petitioners' $40 million investment became worthless. App. 10a-11a, 83a-84a, 91a-92a, 131a-138a; Dist. Ct. Dkt. 84 at 33, 40-42.

Petitioners' auditing expert testified that Respondent's audit work papers showed that it knew or should have known from the "subsequent events review" in February 1998 that FPA was rapidly running out of cash, creating a liquidity crisis, and that FPA was not viable as a going concern. He testified that Respondent's 1996 audit decisions caused FPA to materially overstate its earnings and goodwill from 1996 to 1998. He testified that these financial problems made FPA's bankruptcy inevitable, causing Petitioners' losses. App. 153a-180a, 192a-198a.

Respondent offered no evidence that it exercised "due diligence"; that the registration statement inaccurately described what Petitioners reasonably considered material; that the registration statement disclosed Respondent's knowledge about FPA's true financial condition; that Petitioners had actual knowledge of FPA's true financial condition from information outside the registration statement; or that Petitioners' losses had some cause other than the information about FPA's financial condition that Respondent knew or should have known but failed to disclose when the registration statement became effective. *Cf.* App. 56a-81a.

Instead, Respondent's "loss causation" expert opined that because some market analysts published reports largely dismissing questions about Respondent's approval of FPA's 1996 revenues, the market had "absorbed" all relevant information into FPA's stock price, thus making Respondent's misstatements immaterial. He agreed with Petitioners that the information disclosed in FPA's first-quarter 1998 report triggered the collapse of its stock value, but he did not recognize any connection between

that information and Respondent's disclosure duties as identified by Petitioners' auditing expert. App. 11a, 23a-24a, 112a-126a; Dist. Ct. Dkt. 148, Exhibit A at 12, 30-32.

An independent source agreed with Petitioners' auditing expert about what Respondent's audits concealed and about what caused Petitioners' losses. In late December 1997, just before the FPA-St. Joseph-Orange Coast merger, lead FPA lender BankBoston increased an existing $275 million credit line by another $40 million. BankBoston did so after reviewing exactly the same financial information made available to Petitioners – the 1996 audited financial statements and the 1997 quarterly statements – as well as interviewing FPA's chief financial officer and Respondent's auditors. As FPA was collapsing in June 1998, BankBoston wanted to know why. Its internal analysis succinctly concluded: "Why has the company's financial condition declined so quickly and so dramatically? [¶] Earnings were significantly less than what management and the company's audited financial statements represented" because of "very aggressive accounting." FPA's May 15, 1998 announcement of its "severe liquidity situation" came as "a major surprise to the market." App. 196a, 210a-211a, 218a.

RULINGS BELOW

Petitioners brought claims under the Securities Act of 1933 for the misrepresentations in the registration statement and prospectus against four FPA directors and officers, FPA's investment bank, and Respondent. Petitioners sued in their own names, not as a class action. Petitioners brought no "fraud-on-the-market" claims under SEC Rule 10b-5 or Section 10(b) of the Securities Exchange Act of 1934. Dist. Ct. Dkt. 84 at ¶¶ 1(a), 2, 6, 21. The District Court found Petitioners' allegations sufficiently established

that Respondent's material misrepresentations caused Petitioners' losses to defeat Respondent's motion to dismiss the operative complaint. Dist. Ct. Dkt. 75.

FPA's chief financial officer, Steven Lash, was indicted on multiple fraud counts stemming principally from FPA's false earnings reports. The District Court refused to permit Petitioners any interrogatories or depositions of Lash or chief executive officer Seth Flam, who invoked their Fifth Amendment privilege against self-incrimination. The District Court allowed Petitioners limited discovery of documents received by the grand jury, recognizing that the indictment arose from the same false financial information; however, Petitioners did not receive the grand jury material until after the District Court had already ordered summary judgment for Respondent. App. 192a-193a, 222a-236a; Dist. Ct. Dkts. 133, 135, 142; *In re February 2000 Grand Jury (Madden v. United States)*, No. 02-MC-0259-W (S.D. Cal., filed Sept. 10, 2002) (Whelan, J.).

Even though Respondent admitted that it misstated FPA's 1996 audited revenues and claimed no due diligence, the District Court granted Respondent's motion for summary judgment without applying the strict liability standard under Section 11. The District Court held that Respondent could disprove the materiality of its misstatements based on what the *market* would allegedly consider material, which it based on analyst reports without evidence that any Plaintiff knew about those reports. The District Court gave no consideration to what *Petitioners* reasonably considered material, as demonstrated by the representations and warranties FPA made to Petitioners' former corporations in the registration statement, or to the absence of proof by Respondent that Petitioners knew anything about FPA outside the registration statement. The District Court held Respondent

disproved the materiality of the admitted misstatements because they represented only 3.7% of 1996 revenues. The resulting 150% overstatement of 1996 earnings and $78 million overstatement of assets did not persuade the District Court of materiality. The District Court held Respondent not liable for concealing the material change in FPA's financial condition since the 1996 audit, despite the "subsequent events review" required by GAAS, and therefore disregarded the continuing overstatement of earnings in 1997 and 1998 resulting from the 1996 revenue recognition policy. Construing the misstatements at issue as limited to a specific percentage of 1996 revenues, the District Court held that this misstatement did not cause Petitioners' losses. App. 13a-25a.

Petitioners appealed after obtaining a small fraction of their damages by settling their remaining claims against the directors and officers for the available insurance policy limits. In the meantime Lash was convicted of fraud and waived all post-conviction relief, but the Ninth Circuit refused Petitioners' request for judicial notice of the conviction. The Ninth Circuit affirmed the District Court's rulings in every respect. App. 1a-6a, 26a-31a, 35a-37a.

REASONS FOR GRANTING THE PETITION

This Court should grant the petition for a writ of certiorari to eliminate splits of authority interpreting materiality for claims arising from a specific securities filing rather than fraud on the market. This Court has defined materiality as established when "the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *TSC Indus., Inc. v. Northway,*

Inc., 426 U.S. 438, 449 (1976); *see also Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).[3]

The Circuits have divided over what comprises the "total mix of information *made available*" when a claim arises from a specific securities filing directed to the securities holder. Until recently, the Circuits considered only the contents of the specific filing to determine whether it was materially misleading. But the Eighth and Ninth Circuits have begun to consider information *outside* the securities filing, without evidence that the securities holder actually knew that information, splitting from the Third, Fifth, and Seventh Circuits. This Court should grant certiorari because this trend conflicts with the text of Section 11 and related statutes, which impose liability for materially misleading securities filings based solely on their contents, absent proof as an affirmative defense that the purchaser "knew of such untruth or omission." In closely related errors, the lower courts virtually eliminated the auditor's due diligence duty and applied an arbitrary percentage threshold for materiality, making this case especially suitable for reviewing the materiality of misstatements within the auditor's responsibility.

The Court should also review the affirmative defense of absence of loss causation. Although the courts below treated this issue as an independent ground for their rulings, the defense depends directly on the determination of materiality.

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[3] *TSC* adopted that standard for proxy solicitation cases under Section 14(a) of the Securities Exchange Act of 1934 and SEC Rule 14a-9. *Basic* extended it to fraud cases under Exchange Act Section 10(b) and Rule 10b-5. This Court has not explicitly extended the *TSC* definition to claims under Section 11 or Section 12 of the Securities Act of 1933, although *Basic* described *TSC* as defining "a standard of materiality under the securities laws." *Basic*, 485 U.S. at 231.

The courts below did not have the benefit of this Court's recent decision in *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. ___, 125 S. Ct. 1627 (2005). The decisions below violated *Dura*'s essential principle: that courts should interpret "loss causation" under the securities laws consistently with the traditional tort law principle of "proximate cause." *Dura*'s rule is satisfied by evidence that public disclosure of material information reasonably discoverable by the auditor but omitted from the registration statement caused a 75% drop in stock price and that the company rapidly went bankrupt.

Both issues warrant certiorari because the decisions below typify a trend to engraft aspects of Rule 10b-5 fraud-on-the-market claims onto Securities Act claims, contrary to the statutory text. This Court should grant certiorari to preserve "the special protection afforded to purchasers in a registered offering by the 1933 Act." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983).

I. Congress enacted explicit private remedies under the Securities Act imposing strict liability on participants in securities distributions absent due diligence to ensure full disclosure.

After the Wall Street crash of 1929, Congress adopted the Securities Act of 1933 as the first federal consumer protection statute relating to securities. Upon signing the Securities Act, President Roosevelt hailed the change of securities law "from a system of *caveat emptor* to one of *caveat vendor*." Congress rejected the approach of state "blue sky" laws, in which regulators would allow the sale only of securities with proven merit. Instead, Congress adopted a system of full and fair disclosure of all aspects of securities being marketed, believing this would provide the protection investors needed. THOMAS LEE HAZEN,

FEDERAL SECURITIES LAW 1-2 (Fed. Judicial Ctr., 2d ed. 2003).

The Securities Act imposes no duties on purchasers, but it imposes stringent investigation and disclosure duties on securities issuers and their underwriters and auditors who prepare the two principal disclosure documents: the registration statement and the prospectus. The 1933 Act protects purchasers from violations of these duties not primarily by regulatory action – Congress did not even establish the SEC until 1934 – but by giving purchasers explicit private causes of action under Section 11 and Section 12 for materially misleading registration statements and prospectuses. *Id.* at 2-3, 59-70 & nn.9-10; *see* 15 U.S.C. §§ 77k, 77*l* (excerpted at App. 44a-47a). This Court has recognized that Congress intended "to promote full and fair disclosure of information" by imposing "*in terrorem*" liability on participants in the distribution of securities. *Pinter v. Dahl,* 486 U.S. 622, 646-47 (1988) (applying Section 12).

Section 11 imposes strict liability on auditors for material misrepresentations and omissions in parts of registration statements they certify. They can avoid strict liability only by proving the affirmative defense of "due diligence," reducing the standard to negligence. *See Herman & MacLean, supra,* 459 U.S. at 382. Despite the importance of this statutory remedy, this Court has never directly reviewed the scope of auditor liability under Section 11. *See Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 208 (1976) (citing *Escott v. BarChris Constr. Corp.,* 283 F.Supp. 643, 697-703 (E.D.N.Y. 1968)).

These statutory causes of action differ sharply from the principal private cause of action under the Securities Exchange Act of 1934, first recognized by judges in 1946 as implied in Exchange Act Section 10(b) and SEC Rule 10b-5.

While the Securities Act regulates only persons who participate in issuing securities to their initial purchasers and holds them to strict liability absent due diligence, the Exchange Act regulates fraudulent practices by *all* participants in the *secondary* securities market, even long after the distribution regulated by Section 11. The elements of the Rule 10b-5 claim include reliance by the plaintiff and scienter by the defendant, both absent from Section 11. In 1988 this Court recognized the "fraud-on-the-market" theory, enabling Rule 10b-5 class action plaintiffs to invoke a presumption of reliance on the integrity of an "efficient" public market by showing that material misstatements or omissions adversely affected the market price. *Basic, Inc. v. Levinson,* 485 U.S. 224 (1988); HAZEN, *supra,* at 3-4, 111-13, 117-18; *see* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

This Court has recognized that Section 11 and Rule 10b-5 "involve distinct causes of action and were intended to address different types of wrongdoing." *Herman & MacLean v. Huddleston,* 459 U.S. 375, 381 (1983).

II. This Court should eliminate the split of authority on determining materiality in claims arising from specific federal securities filings.

The Circuit Courts have extended the *TSC* standard for materiality as "the 'total mix' of information made available" from its original context of Exchange Act Section 14(a) to the entirety of federal securities law, including Securities Act Sections 11 and 12. *See Flamm v. Eberstadt,* 814 F.2d 1169, 1174 (7th Cir. 1987). Proxy solicitation, registration statement, and prospectus claims under these statutes all concern a single materially misleading document designed to induce action by investors. This Court should grant certiorari to resolve a split of authority among

these statutes on whether information outside the specific securities filing at issue can form part of the total mix of information made available to the investor.

The prospectus and registration statement substantially overlap in substance, form, and function. The registration statement authorizes distribution of a security to investors; the prospectus must accompany each share upon its first sale. From the investor's standpoint no practical difference exists between these documents, because they must incorporate virtually the same information, including audited financial statements. 15 U.S.C. §§ 77e(b), 77j(a)(1), 77aa (Schedule A, items 25-26); *see* Dist. Ct. Dkt. 84 at 29. Congress recognized that these two documents, "because of their wide dissemination, determine the market price of the security." H.R. REP. No. 85, 73d Cong., 1st Sess. 10 (1933). Congress enacted parallel operative language for Section 11 and Section 12, imposing liability for material misstatements the document "contained" or "include[d]" or for material omissions, absent proof that the purchaser "knew of such untruth or omission," and imposing on the distribution participant the duty of exercising "reasonable care" or "reasonable investigation" to discover the truth. *See id.* at 9; *compare* 15 U.S.C. § 77k(a), (b)(3), (c) *with* § 77*l*(a)(2). The proxy statement serves a similar purpose: "to ensure disclosures by corporate management in order to enable the shareholders to make an informed choice." *TSC v. Northway, supra,* 426 U.S. at 448.

The similarity of Section 11 to Section 12, and of the registration statement to the prospectus, warrant the same treatment of the "total mix of information made available" to determine materiality. Following this Court's decision *TSC v. Northway, supra,* 426 U.S. 438 (1976), the Circuit Courts have universally held that the "total mix of information

made available" in Section 12 prospectus cases and Section 14(a) proxy solicitation cases includes only information reasonably made available in the specific securities filing at issue. These courts have refused to impute constructive knowledge of information allegedly in the public domain, such as other SEC filings and press reports, holding that the availability of truthful information elsewhere cannot excuse untruths or misleading omissions because Section 12, like Section 11, requires the defendant to prove the purchaser had actual knowledge of the truth.[4]

The SEC has urged this view of Section 11 in *amicus curiae* briefs filed in the Second and Fifth Circuits.[5] But the Circuit Courts are increasingly treating Section 11 differently

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[4] Proxy statement cases: *TSC v. Northway, supra,* 426 U.S. at 453 (proxy statement potentially misleading because it omitted information included in other SEC filings); *Koppel v. 4987 Corp.,* 167 F.3d 125, 131-32 (2d Cir. 1999); *In re Westinghouse Sec. Litig.,* 90 F.3d 696, 714 (3d Cir. 1996); *United Paperworkers Int'l Union v. International Paper Co.,* 985 F.2d 1190, 1198-99 (2d Cir. 1993); *Zell v. Intercapital Income Sec. Inc.,* 675 F.2d 1041, 1043-44 (9th Cir. 1982); *see Virginia Bankshares v. Sandberg,* 501 U.S. 1083 (1991) (explaining *TSC*).

Prospectus cases: *Wright v. National Warranty Co.,* 953 F.2d 256, 262 (6th Cir. 1992); *Haralson v. E.F. Hutton Group, Inc.,* 919 F.2d 1014, 1032 & n.10 (5th Cir. 1990); *Casella v. Webb,* 883 F.2d 805, 809 (9th Cir. 1989); *Sanders v. John Nuveen & Co.,* 619 F.2d 1222, 1228-29 (7th Cir. 1980); *Alton Box Board Co. v. Goldman, Sachs & Co.,* 650 F.2d 916, 919-20 & nn.3 & 5 (8th Cir. 1977); *Dale v. Rosenfeld,* 229 F.2d 855, 858 (2d Cir. 1956); *see also Dunn v. Borta,* 369 F.3d 421, 428-30 (4th Cir. 2004) (applying *TSC* standard to state-law counterpart of Section 12); *MidAmerica Fed. Sav. & Loan Ass'n v. Shearson/American Express, Inc.,* 886 F.2d 1249, 1256-57 (10th Cir. 1989) (same).

[5] Brief of SEC in *Merritt v. Merrill Lynch & Co.,* No. 03-7978, (2d Cir. filed June 22, 2004), available at www.sec.gov/litigation/briefs/merritt.pdf; brief of SEC in *Kapps v. Torch Offshore, Inc.,* No. 03-30227 (5th Cir. filed June 9, 2003), available at www.sec.gov/litigation/briefs/kapps.pdf; *see Kapps v. Torch Offshore, Inc.,* 379 F.3d 207, 218 n.16 (5th Cir. 2004) (citing brief). The Second Circuit has not yet decided *Merritt.*

without reconciling their decisions to the statutory requirement of "prov[ing] that at the time of such acquisition [the purchaser] knew of such untruth or omission." 15 U.S.C. § 77k(a). None have done so more dramatically than the Ninth Circuit and the District Court in their decisions below.

A. The lower courts imputed constructive knowledge to Petitioners of information outside the registration statement, widening a split of authority on what constitutes the "total mix of information made available" in registration statement cases.

Five Circuits have split on the application of the *TSC* materiality standard under Section 11. The Third and Fifth Circuits hold that materiality is determined only by "the 'total mix' of information *the document* provided investors." *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371 (3d Cir. 1993) (italics added); *Krim v. Banc-Texas Group, Inc.*, 989 F.2d 1435, 1448 (5th Cir. 1993). The Third Circuit holds purchasers responsible only for information indisputably "obvious" to a "reasonable investor," such as general economic conditions. *Trump*, 7 F.3d at 377. In later cases these Circuits have excused omissions of information that is available in newspapers but has less obvious connections to the registrant's business fortunes. *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 209, 216 (5th Cir. 2004) (effect of natural gas prices on pipeline service company's share value); *Klein v. General Nutrition Cos.*, 186 F.3d 338, 342-43 (3d Cir. 1999) (effect of deodorized distillate shortage on Vitamin E production). But as Judge Easterbrook has explained for the Seventh Circuit, this logic can fairly extend no further than general information about "the industry as a whole"; Section 11 still requires full disclosure of "*firm-specific* information." *Wielgos v.*

Commonwealth Edison Co., 892 F.2d 509, 515 (7th Cir. 1989).

A divided Eighth Circuit panel split from these decisions in a case involving GAAP violations, the most common and objectively verifiable form of actionable misstatement;[6] the SEC deems GAAP violations presumptively misleading. 17 C.F.R. § 210.4-01(a)(1). The panel found a registration statement not materially misleading even though it reported earnings inflated by an undisclosed GAAP violation, holding materiality disproved by the plaintiffs' failure to allege that a Form 10-Q filed three weeks later also violated GAAP when reporting the same accounting decision in more detail. *Romine v. Acxiom Corp.*, 296 F.3d 701, 703, 705-06 (8th Cir. 2002). The dissent contended that the Form 10-Q tended to *prove* rather than disprove materiality because it helped trigger a substantial stock price drop. *Id.* at 709-11 (Bye, J., dissenting).

The decisions below by the Ninth Circuit and the District Court entirely abandoned the statutory language requiring proof that purchasers had actual knowledge of information outside the registration statement to determine materiality, in conflict with the Third, Fifth, and Seventh Circuit decisions above and all Circuit-level decisions under Section 12 and Section 14(a). The Ninth Circuit declared materiality absent because "by March 1998 *the market* was fully aware of the material economic facts regarding the guaranteed access fund payments,

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[6] About 50% to 60% of securities class actions allege specific GAAP violations. Stanford Law School Securities Class Action Clearinghouse and Cornerstone Research, *Securities Class Action Case Filings 2004: A Year in Review* 16 (2005), *available at* http://securities.cornerstone.com/pdfs/YIR2004.pdf. No known data is available for claims brought by named litigants like Petitioners.

FPA's decision to account for the payments as revenue, and the controversial nature of the revenue treatment." The District Court cited analyst reports purportedly "available to a reasonable investor" and declared it "indisputable that a reasonable investor had already included GAF revenue misstatements as part of the 'total mix of information,'" citing *Basic, Inc. v. Levinson, supra,* 485 U.S. 224 (1988), as authority for imputing constructive knowledge of the analyst reports to Petitioners. App. 4a, 20a, 23a (italics added).

But *no evidence* in the record established that any of the sixty-one Petitioners "knew of" the analyst reports or the GAAP and GAAS violations, as Section 11's plain text requires. *No evidence* established that either the analyst reports or the GAAP and GAAS violations formed part of the "total mix of information made available" *in the registration statement,* which disclosed only Respondent's clean audit opinion. The courts below made no attempt to square their decisions with the language of Section 11, which provides no textual support for the duties they imposed on Petitioners.

More troubling still, the information charged to Petitioners' constructive knowledge neither existed in the public domain nor explained the specific accounting violations at issue. The analyst reports about FPA were not available to Petitioners for the price of a daily newspaper, unlike the information at issue in *Trump*, 7 F.3d at 377 (general economic conditions) or *Kapps,* 379 F.3d at 216 (natural gas prices). The District Court laid the most emphasis on a report by CFRA, which sells its reports to institutional investors for a monthly subscription of $3,000, a price far beyond the reach of typical investors. App. 20a; Ninth Circuit Excerpts of Record, at 3147.

Most troubling of all, the courts below expected Petitioners to disbelieve Respondent's "expertised" audit reports based on its exclusive access as FPA's auditor to FPA's internal accounting records, by charging Petitioners with constructive knowledge of non-expertised second-hand reports of persons having no role in the distribution of securities to Petitioners and no duties under the Securities Act. Expecting securities purchasers to disregard audit reports frustrates the purpose of Section 11. It contradicts the explicit warning of the registration statement that information outside the registration statement "should not be relied upon as having been authorized by FPA." App. 50a. The "perceived superiority" of Respondent's knowledge and expertise "far exceeding the normal investor's resources" made Respondent's audit opinions material no matter what information may have existed elsewhere. *See Virginia Bankshares v. Sandberg,* 501 U.S. 1083, 1090-91 (1991) ("perceived superiority" of corporate directors).

The testimony of Respondent's "fraud-on-the-market" expert, who provided the analyst reports to the courts below, establishes why those reports had no relevance to determining the materiality of misrepresentations made to Petitioners. The very fact that Respondent's expert witness had to perform a complex statistical "event study" to interpret the analyst reports by itself proves that his conclusions were not reasonably available to Petitioners in the public domain. "If it would take a financial analyst to spot the tension between the [true] and the [deceptive], whatever is misleading will remain materially so, and liability should follow." *Virginia Bankshares, supra,* 501 U.S. at 1097. In performing his analysis, Respondent's witness ignored the merger agreement included in the registration statement and its requirement for clean audit opinions. He disclaimed any opinion about whether FPA's

financial statements were materially misleading. He acknowledged that analysts reported favorably that Respondent had approved FPA's revenue recognition. In short, like virtually all the analysts whose reports the expert reviewed, he did not question the propriety of FPA's financial statements; he presumed it. App. 112a-126a; Dist. Ct. Dkt. No. 148, Exhibit A, at 6-10.

The view adopted by the lower courts threatens to extinguish the auditor's duties under Section 11 entirely because it recognizes no logical limit to what an auditor may misstate or omit. An auditor could intentionally make untrue statements in its audit reports but escape liability because a complete stranger to the distribution of the securities suspects the lie. This view thwarts Congressional intent "to throw the burden of disproving responsibility for reprehensible acts of omission or commission on those who purport to issue statements for the public's reliance. . . . To impose a lesser responsibility would nullify the purposes of this legislation." H.R. REP. No. 85, *supra,* at 9-10.

The lower courts have abused this Court's formulation of "the total mix of information made available" by including information manifestly *not* made available in the specific securities filing or otherwise known to the purchasers, contrary to the statutory language Congress adopted. This Court has not addressed materiality under Section 11 since its enactment in 1933. The Court should now do so by granting certiorari to eliminate this abuse.

B. The lower courts nullified the auditor's duty of due diligence, the primary duty Congress sought to impose on auditors.

Section 11 imposes a comprehensive duty on the auditor: "reasonable investigation" and "reasonable care,"

commonly known as "due diligence." As the House report on the Securities Act explained:

> For those whose moral responsibility to the public is particularly heavy, there is a correspondingly heavier legal liability – . . . the accountants . . . are liable to the buyer not only if they cannot prove they did not know of the flaw in the information offered to the public but also if they cannot prove that they could not have found that flaw "after reasonable investigation" and that they "had reasonable ground to believe and did believe * * * that such statement was true or that there was no such omission."

H.R. REP. No. 85, *supra,* at 9, *cited in Herman & MacLean v. Huddleston, supra,* 459 U.S. at 381-82 & n.12. After the 1929 stock market crash, Congress intended to impose "a duty of competence as well as innocence which the history of recent spectacular failures overwhelmingly justifies." *Id.* Auditors can avoid "virtually absolute" liability for material misstatements and omissions *only* if they carry "the burden of demonstrating due diligence." *Herman & MacLean, supra,* 459 U.S. at 382; *Ernst & Ernst v. Hochfelder,* 425 U.S. 185, 208 (1976). Proper application of the due diligence duty thus becomes essential to determining which material misstatements and omissions trigger auditor liability.

Congress left no ambiguity about the time for judging the auditor's due diligence. The auditor must prove it reasonably believed, after a reasonable investigation, that any part of the registration statement it certified was not materially misleading "at the time such part of the registration statement became effective." 15 U.S.C. § 77k(b)(3)(B); App. 44a-45a. This means the auditor cannot rest upon its most recent full audit, which it may have completed many

months before the registration statement becomes effective. Instead, the auditor must prove that the latest audit has not *become* misleading. The auditor must make a reasonable investigation to discover and disclose "whether any material change has occurred in the company's financial position which should be disclosed in order to prevent the [most recent audit] from being misleading." *Escott v. BarChris Constr. Corp.*, 283 F.Supp. 643, 697-98, 701-02 (E.D.N.Y. 1968), cited with approval in *Ernst, supra,* 425 U.S. at 208. The auditor signifies that it has performed this investigation by issuing a written consent to the incorporation of its past audit opinions in the registration statement. 15 U.S.C. § 77g(a); App. 43a-45a.

The lower courts essentially nullified the *Ernst/Escott* rule of auditor due diligence. Respondent offered no evidence or argument that it made any reasonable investigation. The Ninth Circuit recognized that the registration statement became effective on February 17, 1998; that Petitioners charged Respondent with misrepresentations occurring *at that time*; and that "FPA changed drastically in the fifteen months after the 1996 audit." Yet the Ninth Circuit absolved Respondent of disclosing what it knew about those drastic changes. The District Court likewise declared that because Respondent foreswore any claim of due diligence, "*Escott* deals with a defense not at issue in this case." The lower courts held Deloitte responsible only for what it knew when it completed the 1996 audit. App. 3a-4a, 13a-16a.

The lower courts violated the *Ernst/Escott* rule and Congressional intent by charging Petitioners, rather than Respondent, with discovering how drastically FPA had changed since Respondent's last audit. That drastic change should have heightened Respondent's responsibility.

Although GAAS does not require a full audit, it does require the auditor to investigate any "danger signals" of a "material change for the worse"; Section 11 holds the auditor liable for whatever it should have discovered. *Escott,* 283 F.Supp. at 702-03. The auditor must evaluate the unaudited interim financial statements, because they form part of the "total mix of information made available" in the registration statement. *See id.* at 701-03. Instead of holding Respondent to such an investigation, the lower courts relieved Respondent of any duty at all.

The lower courts' mistaken view of Respondent's due diligence duty impermissibly "narrowed [Respondent's] potential liability" (App. 17a) to investigate FPA's financial condition as of 1996 rather than as of February 17, 1998, when the registration statement became effective, rendering Respondent's written consent in the registration statement an empty formality. Despite Respondent's frequent consultations with FPA during 1997 about FPA's revenue and earnings reporting, its participation in deflecting SEC inquiries about that subject, and its documented fear of FPA's impending bankruptcy – all of which Respondent *actually knew,* even without investigation – the lower courts failed to hold Respondent responsible for probing these "danger signals," in violation of *Escott* and *Ernst*. By excusing Respondent from the explicit statutory duty of reasonable investigation, the lower courts narrowed their inquiry for materiality almost to the vanishing point.

C. The lower courts applied an arbitrary numerical benchmark for materiality of misstated revenues while ignoring significantly misstated earnings, contrary to other Circuits and the SEC.

The courts below also split from two other Circuits as well as the SEC in determining the materiality of misstated revenue as a matter of law while disregarding the significantly greater effect of the same misstatement on earnings. The District Court held Respondent's *admitted* misstatements in the 1996 audit immaterial as a matter of law because they represented 3.7% of total revenues, disregarding that the same accounting decision caused a $78 million misstatement of balance sheet assets and a 150% distortion of earnings. The Ninth Circuit decision offers little detail, but discussed the misstated revenues to the exclusion of earnings and assets. App. 4a, 19a-21a.

The decisions below conflict with the SEC's authoritative opinion, consistent with two Circuits, that a reasonable investor will virtually always find earnings misstatements highly material, particularly if intentional:

> [The SEC] staff believes that a registrant and the auditors of its financial statements should not assume that even small intentional misstatements in financial statements, for example those pursuant to actions to "manage" earnings, are immaterial. . . . The evidence may be particularly compelling where management has intentionally misstated items in the financial statements to "manage" reported earnings. In that instance, it presumably has done so believing that the resulting amounts and trends would be significant to users of the registrant's financial statements.

Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45152 (1999) (footnotes omitted). Even a "quantitatively small" unintentional misstatement is material if it "masks a change in earnings" or "hides a failure to meet analysts' consensus expectations." Likewise, "when management or the auditor expects . . . that a known misstatement may result in a significant positive or negative market reaction," that demonstrates materiality. *Id.* SAB 99 summarizes existing law, applying this Court's materiality standard to earnings misstatements. *Id.* at 45151 & n.4, 45155 & n.50 (citing *TSC v. Northway, supra,* 426 U.S. at 449, 450, and *Basic v. Levinson, supra,* 485 U.S. 224.)

Recognizing the importance investors place on accurate earnings reporting, the Second and Eighth Circuits have held significant earnings misstatements material even if they reflect a small misstatement of revenues. *Ganino v. Citizens Utils. Co.,* 228 F.3d 154, 162-64 (2d Cir. 2000) (applying SAB 99 at urging of SEC as *amicus curiae*); *Gebhardt v. ConAgra Foods, Inc.,* 335 F.3d 824, 829-831 (8th Cir. 2003). Both *Ganino* and *Gebhardt* concerned Rule 10b-5 claims involving far less egregious misstatements of revenues and earnings. In *Ganino,* the company improperly recognized $10.1 million in revenue so it could continue a trend of reporting increased earnings; the misstatement distorted revenues by only 1.7% but overstated revenues by 15.78%. In *Gebhardt,* the company improperly recognized revenue before it was actually earned, amounting to only 0.4% of total revenues but overstating earnings by 8%. In each case, the Circuit Court reversed a trial court ruling that the quantitatively small misstatement of revenues was immaterial as a matter of law, holding that a reasonable investor would find the earnings misstatements material.

Ganino, 228 F.3d at 157-60, 162-64; *Gebhardt,* 335 F.3d at 827-28, 830-31.

"Most investors would consider it significant, no matter what the mix of information available, that a company was not earning as much as it was claiming to earn." *Gebhardt,* 335 F.3d at 830. Indeed, "earnings reports are among the pieces of data that investors find most relevant to their investment decisions." *Ganino,* 228 F.3d at 166; *see also In re Burlington Coat Factory Sec. Litig.,* 114 F.3d 1410, 1420 n.9 (1st Cir. 1997).

Respondent concealed a far more serious 150% overstatement of earnings. Management "invented" the guaranteed access fund to beat Wall Street earnings expectations, knowing that disclosure of this earnings management "would have a dramatic, negative effect on the company that would virtually eliminate any hope of equity raising in the future." App. 187a. This prediction came true when the guaranteed access fund ran dry and FPA disclosed earnings 30¢ below analyst expectations, triggering a 75% stock price drop. Respondent admitted that its 1996 audit violated GAAP and GAAS in approving the revenue recognition policy that enabled this fraud, which resulted in the conviction and imprisonment of FPA's chief financial officer. Respondent's continuing review of FPA's revenue recognition throughout 1997 in direct response to SEC scrutiny, and again within three days of the registration statement becoming effective, App. 188a-190a, demonstrates that this fraud was well within the reach of a reasonable investigation by Respondent.

III. This Court should review the decision below because its loss causation analysis conflicts with this Court's recent decision in *Dura Pharmaceuticals, Inc. v. Broudo.*

After the decision and denial of rehearing below, this Court reversed another Ninth Circuit ruling on loss causation as an element of a Rule 10b-5 fraud-on-the-market class action. *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. ___, 125 S. Ct. 1627 (2005). The decision below conflicts with *Dura* and resulted directly from the Ninth Circuit's mistaken materiality analysis. This Court should therefore grant certiorari on loss causation.

A. Under ordinary tort law principles, loss causation requires only a causation connection between the material misrepresentation and the loss.

Under Rule 10b-5 the plaintiff must prove loss causation as an element of the claim, but under Section 11 a defendant must prove the *absence* of loss causation as an affirmative defense. *Dura,* 125 S. Ct. at 1633; 15 U.S.C. § 77k(e); App. 45a-46a. Regardless who bears the burden of proof, loss causation draws its meaning from the ordinary tort principle of "proximate causation": "a causal connection between the material misrepresentation and the loss." *Dura,* 125 S. Ct. at 1631, 1633. The "judicial consensus[] says that a person who 'misrepresents the financial condition of a corporation in order to sell its stock' becomes liable to a relying purchaser 'for the loss' the purchaser sustains 'when the facts . . . become generally known' and 'as a result' share value 'depreciate[s].'" *Id.* at 1633 (quoting RESTATEMENT (SECOND) OF TORTS § 548A cmt. b at 107 (1977), most alterations original).

Under its former approach, the Ninth Circuit held loss causation established when an "inflated purchase price . . . 'touches upon' a later economic loss." This Court "rejected the Ninth Circuit's 'inflated purchase price' approach to proving causation and loss," finding it irreconcilable with proximate causation. *Id.* at 1632-33.

The decision below applied the same "inflated purchase price" approach to loss causation, conflicting with *Dura*. The Ninth Circuit held loss causation disproved because "FPA's early 1988 *[sic, 1998]* stock price was not inflated by any misrepresentations regarding guaranteed access fund payments." App. 5a. The courts below failed to ask the question *Dura* requires: whether Respondent's misrepresentation of FPA's financial condition by issuing an unqualified consent to incorporation of its prior audit reports into the registration statement caused Petitioners' losses because FPA stock depreciated when the misrepresented facts became generally known. *Cf. Dura,* 125 S. Ct. at 1633. The "touches upon" approach effectively severed the lower courts' loss causation inquiry from the principles of proximate causation. The lower courts' application of the approach this Court disapproved in *Dura* therefore warrants certiorari.

B. The lower courts' improperly narrow materiality inquiry also caused them to view loss causation too narrowly.

The Ninth Circuit offered another reason for its loss causation decision that conflicts less obviously with *Dura*, stating that "FPA's stock decrease after March 20, 1998, was not caused by revelations regarding guaranteed access-fund payments." The Circuit opinion appears to reflect the District Court's characterization of the issue as requiring proof of "how the December 1996 $16.45 million

revenue misstatement directly related to the March 1998 adverse disclosures." App. 5a, 24a. But these formulations indeed conflict with *Dura,* and resulted from the lower courts' impermissibly narrow view of materiality.

The text of Section 11(e) directly ties the loss causation analysis to the evaluation of materiality, using the same phrase that defines materiality in Section 11(a). 15 U.S.C. § 77k(a), (e). *Dura* correctly frames the issue: Respondent had a duty to correctly represent "the financial condition of [the] corporation." 125 S. Ct. at 1633. As explained in Part II above, Respondent had a duty under Section 11 to investigate FPA's financial condition as of the date the registration statement became effective, and to disclose "whether any material change has occurred in the company's financial position which should be disclosed in order to prevent the [most recent audit] from being misleading." *Escott v. BarChris, supra,* 283 F.Supp. at 701-02.

The courts below erred because they did not consider the causal connection between the stock price drop and *all* material aspects of FPA's financial condition that Respondent should have disclosed: FPA's fraudulent earnings management, the balance sheet overstatement concealing a negative net worth, and the severe danger of bankruptcy. The record easily establishes that FPA's stock price dropped by 75% when FPA disclosed drastic negative changes to its reported earnings and assets as well as the liquidity crisis that soon caused bankruptcy and made FPA's stock completely worthless, causing Petitioners to lose a $40 million investment made just three months earlier. *Cf. Dura,* 125 S. Ct. at 1632 (brief time between misrepresentation and loss implies causation).

The decisions below also failed to correctly account for the burden of proof that Section 11 expressly imposed on Respondent. 15 U.S.C. § 77k(e); *cf. Dura,* 125 S. Ct. at 1633. In order to avoid liability for *all* damages, Respondent had to prove that "*all* [Petitioners'] damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which is liability is asserted," being materially false or misleading; evidence showing that only a "portion" of Petitioners' damages had a cause other than Respondent's material misrepresentations allows Respondent to avoid liability only for "such portion." 15 U.S.C. § 77k(e) (italics added); App. 46a. To obtain summary judgment, Respondent had the burden of proving the *complete absence* of any causal connection between its February 1998 disclosure duties and the May 1998 stock price drop. Respondent did not meet that burden. At most, its evidence indicated triable facts for an apportionment of Petitioners' damages between Respondent's misrepresentations and other causes. Any triable fact issue should have precluded summary judgment on the issue of loss causation.

Because the Ninth Circuit's loss causation inquiry conflicts so directly with *Dura,* this Court may consider granting certiorari, vacating, and remanding for the Ninth Circuit to reconsider in light of *Dura*. But the loss causation issue warrants review on the merits in this Court because of its intimate connection with the correct materiality inquiry, and so that this Court can consider the extent of an auditor's liability under Section 11, an issue of great national importance in the wake of accounting scandals leading to the "recent spectacular failures" of several publicly traded companies. *Cf.* H.R. REP. NO. 85, *supra,* at 9. This Court should therefore grant certiorari on both issues.

CONCLUSION

The decisions below thwart the basic purpose of the Securities Act, which requires full disclosure of all facts material to the distribution of securities and allocates to auditors the duty of disclosing material changes in a registrant's financial condition even when they occur after the most recent audit. The decisions of the Circuit Courts conflict on whether to judge the materiality of misrepresentations by the "total mix of information made available" in the specific securities filing, reaching different results for registration statements, prospectuses, and proxy statements even though they serve the same ultimate purpose. The decision below on loss causation directly conflicts with this Court's April 2005 decision in *Dura,* warranting reversal. The decisions below present an appropriate vehicle for review of the scope of auditor responsibility and liability under Section 11, an issue of national importance to investors.

Petitioners therefore respectfully request this Court to grant the writ of certiorari.

Respectfully submitted,

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In The
Supreme Court of the United States

CHARLES T. MADDEN, et al.,

Petitioners,

v.

DELOITTE & TOUCHE LLP,

Respondents.

On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

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APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 02-56976
D.C. No. CV-99-01516-TJW

CHARLES T. MADDEN; et al., Plaintiffs, and
NAVIN P. AMIN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE LLP, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

No. 02-56982
D.C. No. CV-99-01516-TJW

CHARLES T. MADDEN; et al., Plaintiffs-Appellants, and
NAVIN P. AMIN; et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

No. 03-55408
D.C. No. CV-99-01516-TJW

CHARLES T. MADDEN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

No. 03-56891

D.C. No. CV-99-01516-LAB

CHARLES T. MADDEN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE; et al., Defendants, and VOLPE BROWN WHELAN & COMPANY, Defendant-Appellee.

[Filed: November 23, 2004]

MEMORANDUM

Appeal from the United States District Court
for the Southern District of California
Thomas J. Whelan, District Judge, Presiding[1]

Argued and Submitted November 2, 2004
Pasadena, California

Before: FERNANDEZ, SILVERMAN, and CALLAHAN, Circuit Judges.

Plaintiffs challenge the district courts' denial of their motions to remand, grant of summary judgment in favor of Deloitte & Touche and Volpe, Brown, Wheelan [sic] & Company,

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[1] Alicemarie H. Stotler, District Judge, Central District of California, presided over the motions to remand and transferred the cases to the Southern District of California.

This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Ninth Circuit Rule 36-3.

and denial of their motions for reconsideration. We have jurisdiction pursuant to 28 U.S.C. § 1291 and affirm.

We review de novo the district courts' grant of summary judgment and denial of the motions to remand for improper removal under the Securities Litigation Uniform Standards Act of 1998 (SLUSA). *Patenaude* v. *Equitable Life Assurance Soc'y of the United States*, 290 F.3d 1020, 1023 (9th Cir. 2002); *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1412 (9th Cir. 1994). We review the district court's denial of motions for reconsideration for an abuse of discretion. *Smith* v. *Pac. Props. & Dev. Corp.*, 358 F.3d 1097, 1100 (9th Cir.), *cert. denied*, 125 S. Ct. 106 (2004).

Plaintiffs argue that the district courts erred in denying remand and holding that SLUSA preempted their state law claims. They argue that the common stock issued pursuant to the merger agreement between FPA Medical Management, Inc. and St. Joseph Medical Corporation/Orange Coast Managed Care Services, Inc. was not a "covered security" under SLUSA because the actual shares of stock were not listed on Nasdaq until after the alleged misrepresentations occurred. A "covered security" under SLUSA includes a security that is "listed, or authorized for listing, on the National Market System of the Nasdaq Stock Market . . . or is a security of the same issuer that is equal in seniority or that is a senior security to a security." 15 U.S.C. §§ 77p(f)(3) and 77r(b)(1). Plaintiffs alleged in their first amended complaints filed in state court that: (1) FPA common stock was traded on Nasdaq at all times relevant to the action; (2) plaintiffs received FPA common stock; (3) the SEC approved registration of plaintiffs' stock on February 17, 1998; and (4) fraud and misrepresentations, that occurred both before and after February 17, 1998, caused plaintiffs to acquire FPA common stock in

exchange for their St. Joseph/Orange Coast stock. These allegations are sufficient to allege that the FPA stock was a "covered security" under SLUSA. The district courts did not err in allowing removal of the amended complaints and holding that the state claims were preempted.

Plaintiffs argue that the district court erred in granting summary judgment for Deloitte and Touche on the § 11 claim on the ground that the alleged misrepresentation in the 1996 financial statement certified in the registration statement was not material. Accountants are liable under § 11 for the financial information that they certify in the registration statement. 15 U.S.C. § 77k(a); 17 C.F.R. § 230.436(c); *Monroe* v. *Hughes*, 31 F.3d 772, 774 (9th Cir. 1994). Because Deloitte did not audit or certify the 1997 quarterly statements in the registration statement, the district court correctly held that Deloitte was not liable for FPA's unaudited 1997 quarterly statements.

A misrepresentation or omission is material if "a reasonable shareholder would consider the misrepresentation or omission important, because it altered the total mix of available information." *Provenz* v. *Miller*, 102 F.3d 1478, 1489 (9th Cir. 1996) (quotation and citation omitted). The undisputed facts established that by March 1998 the market was fully aware of the material economic facts regarding the guaranteed access fund payments, FPA's decision to account for the payments as revenue, and the controversial nature of the revenue treatment. Because FPA changed drastically in the fifteen months after the 1996 audit, the district court did not err in holding that, as a matter of law, Deloitte's approval of the 1996 guaranteed access funds did not alter the total mix of information available to the reasonable shareholder in 1998.

Plaintiffs also argue that the district court erred in granting summary judgment for Deloitte on the issue of loss causation. The court ruled that Deloitte had established that their alleged misrepresentation did not cause plaintiffs' loss. Lack of causation of loss is an affirmative defense to § 11 claims. 15 U.S.C. § 77k(e); *Worlds of Wonder*, 35 F.3d at 1421-22. To establish a loss-causation defense, Deloitte must show that the depreciation in value of FPA's stock resulted from factors other than the alleged material misstatement in the 1996 financial statement. *Worlds of Wonder*, 35 F.3d at 1422. Undisputed expert testimony established that: (1) FPA's early 1988 [sic] stock price was not inflated by any misrepresentations regarding guaranteed access fund payments; and (2) FPA's stock decrease after March 20, 1998, was not caused by revelations regarding guaranteed access-fund payments. The district court did not err in holding that the undisputed evidence established a loss-causation defense for Deloitte.

Plaintiffs next argue that the district court erred in granting summary judgment for Volpe, Brown, Wheelan [sic] & Company on the ground that Volpe was not a § 11 underwriter or a § 12(a)(2) seller. Because the undisputed facts establish that Volpe was FPA's financial advisor for the merger, did not act after the private merger agreement was signed, and did not participate in any way in the solicitation of the Orange Coast shareholders or participate in drafting, preparing, certifying, or underwriting the registration statement, proxy or prospectus, the district court did not err in holding that Volpe is not liable as an underwriter or seller for misstatements in the registration, proxy, prospectus, or public offering. 15 U.S.C. §§ 77k(a) and 77(l)(a)(2); *Gustafson* v. *Alloyd Co.*, 513 U.S.

561, 584 (1995); Kaplan v. Rose, 49 F.3d 1363, 1371 (9th Cir. 1994).

Finally, plaintiffs argue that the district court abused its discretion in denying their motions for reconsideration. To obtain reconsideration, plaintiffs must establish that newly proffered evidence was discovered after the hearing and that they "could not with reasonable diligence have discovered and produced such evidence at the hearing." *Frederick S. Wyle Prof. Corp.* v. *Texaco, Inc.*, 764 F.2d 604, 609 (9th Cir. 1985). Because plaintiffs did not establish that they could not have discovered and produced the "new" evidence while the summary judgment proceedings were pending and because, in any event, the evidence would not have changed the outcome of the summary judgments, the district court did not abuse its discretion in denying the motions.

AFFIRMED.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
SOUTHERN DISTRICT OF CALIFORNIA, SAN DIEGO

Nos. 02-56976, 02-56982, 03-55408, and 03-56891

CHARLES T. MADDEN; et al., Plaintiffs, and,
NAVIN P. AMIN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE, LLP, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

CHARLES T. MADDEN; et al., Plaintiffs-Appellants, and,
NAVIN P. AMIN; et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

CHARLES T. MADDEN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

CHARLES T. MADDEN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE, LLP; et al., Defendants, and
VOLPE BROWN WHELAN & COMPANY, Defendant-Appellee.

[Filed: October 28, 2004]

ORDER

Plaintiffs' Requests for Judicial Notice filed on January 13, 2004 and April 7, 2004 and Supplemental Requests for Judicial Notice filed on July 1, 2004 are DENIED.

Plaintiffs' unopposed Motion for Correction of Record on Appeal filed July 18, 2003 is GRANTED.

FOR THE COURT
CATHY A. CATTERSON
CLERK OF COURT

By: /s/ Howard Hom
Howard Hom
Deputy Clerk

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case No: 99-CV-1516 W (AJB)

CHARLES T. MADDEN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE LLP, et al., Defendants.

[Filed: October 17, 2002]

ORDER GRANTING DEFENDANT DELOITTE & TOUCHE LLP'S MOTION FOR SUMMARY JUDGMENT

Defendant Deloitte & Touche LLP ("Defendant") moves for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. Plaintiffs Charles T. Madden, et al. ("Plaintiffs") oppose. All parties are represented by counsel. The Court decides the matter on the papers submitted and without oral argument pursuant to Civil Local Rule 7.1(d.1). For the reasons outlined below, the Court GRANTS Defendant's motion for summary judgment.

I. BACKGROUND

This action arises out of a stock-for-stock merger between (1) Orange Coast Managed Care Services, Inc.

("OCMCS"), St. Joseph Medical Corporation ("SJMC") and (2) FPA Medical Management, Inc. ("FPA"). At all times relevant to this action, FPA's common stock traded on the NASDAQ National Market System.

In 1996, FPA purchased Foundation Health Corporation's medical clinics ("Foundation"). As part of this purchase, FPA agreed not to cut or reduce any existing services to current Foundation health plan members. In consideration for FPA's forbearance, Foundation paid $55 million in Guaranteed Access Funds ("GAF"). This sum was to be paid over 10 quarters: $16.45 million in 1996; $29.9 million in 1997; and $8.65 million in 1998. FPA received the first GAF payment in December 1996, and recorded the full amount as revenue.

Defendant audited FPA's consolidated financial statements for the years ending December 31, 1995 and December 31, 1996. In those financial statements, Defendant determined that the GAF payments were properly treated as earned revenue. These financial statements were included in FPA's 1996 10-K statement. The 10-K filing was later incorporated by reference in FPA's S-4 registration statement, which allowed FPA the ability to issue shares used in the merger.

On January 13, 1998 OCMCS and SJMC's respective board directors met and separately approved the Merger Agreement. On January 21, 1998 negotiations ended and the Merger Agreement was signed. The merger's closing was conditioned upon shareholder Merger Agreement approval. After signing, FPA and OCMCS, and their respective attorneys, prepared the necessary S-4 Registration Statement containing the combined Proxy Statement/ Prospectus. On February 11, 1998 FPA filed the S-4 Form

with the SEC. On February 17, 1998 it became effective. Subsequently, OCMCS delivered the combined Proxy Statement/Prospectus to OCMCS and SJMC shareholders. The OCMCS and SJMC board of directors then formally recommended that the shareholders approve the Merger Agreement.

On March 20, 1998 the SJMC and OCMCS shareholders approved the merger. FPA issued shares of its common stock to Plaintiffs in an off-market transaction. At that time, the SJMC and OCMCS shares had a combined market value of approximately $60 million. Several weeks after the merger, however, adverse information concerning FPA's financial health became known, causing its stock price to plummet. Plaintiffs subsequently commenced this action for alleged material misstatements in the Registration Statement.

II. LEGAL STANDARD

Summary judgment is appropriate under Rule 56 of the Federal Rules of Civil Procedure if the moving party demonstrates the absence of a genuine issue of material fact and entitlement to judgment as a matter of law. *See* FED. R. CIV. P. 56(c); *Celotex Corp.* v. *Catrett,* 477 U.S. 317, 322 (1986). A fact is material when, under the governing substantive law, it could affect the outcome of the case. *See Anderson* v. *Liberty Lobby, Inc.,* 477 U.S. 242, 248 (1986); *Freeman* v. *Arpaio,* 125 F.3d 732, 735 (9th Cir. 1997). A dispute is genuine if a reasonable jury could return a verdict for the nonmoving party. *See Anderson,* 477 U.S. at 248.

A party seeking summary judgment always bears the initial burden of establishing the absence of a genuine

issue of material fact. *See Celotex,* 477 U.S. at 323. The moving party can satisfy this burden in two ways: (1) by presenting evidence that negates an essential element of the nonmoving party's case; or (2) by demonstrating that the nonmoving party failed to establish an essential element of the nonmoving party's case on which the nonmoving party bears the burden of proving at trial. *See id.* at 322-23. "Disputes over irrelevant or unnecessary facts will not preclude a grant of summary judgment." *T.W. Elec. Serv., Inc.* v. *Pacific Elec. Contractors Ass'n,* 809 F.2d 626, 630 (9th Cir. 1987). "The district court may limit its review to the documents submitted for the purpose of summary judgment and those parts of the record specifically referenced therein." *Carmen* v. *San Francisco Unified Sch. Dist.,* 237 F.3d 1026, 1030 (9th Cir. 2001). Therefore, the court is not obligated "to scour the record in search of a genuine issue of triable fact." *Keenan* v. *Allen,* 91 F.3d 1275, 1279 (9th Cir. 1996) (*citing Richards* v. *Combined Ins. Co.,* 55 F.3d 247, 251 (7th Cir. 1995)). If the moving party fails to discharge this initial burden, summary judgment must be denied and the court need not consider the nonmoving party's evidence. *Adickes* v. *S.H. Kress & Co.,* 398 U.S. 144, 159-60 (1970).

Once the moving party establishes the absence of genuine issues of material fact, the burden shifts to the nonmoving party to set forth facts showing that there remains a genuine issue of disputed fact. *See Celotex,* 477 U.S. at 314. The nonmoving party cannot defeat summary judgment merely by demonstrating "that there is some metaphysical doubt as to the material facts." *Matsushita Elec. Indus. Co., Ltd.* v. *Zenith Radio Corp.,* 475 U.S. 574, 586 (1986); *Triton Energy Corp. v. Square D Co.,* 68 F.3d 1216, 1221 (9th Cir. 1995) (*citing Anderson,* 477 U.S. at

252) ("The mere existence of a scintilla of evidence in support of the nonmoving party's position is not sufficient."). Rather, the nonmoving party must "go beyond the pleadings and by her own affidavits, or by 'the depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.'" *Celotex,* 477 U.S. at 324 (quoting Fed. R. Cir. P. 56(e)).

When making this determination, the court must view all inferences drawn from the underlying facts in the light most favorable to the nonmoving party. *See Matsushita,* 475 U.S. at 587. The court must not weigh the evidence, draw legitimate inferences or make credibility determinations in evaluating a motion for summary judgment. *See Anderson,* 477 U.S. at 255.

III. DISCUSSION

In support of its motion for summary judgment, Defendant makes three arguments. First, Defendant argues that Plaintiffs' § 11 claim is limited to the audited December 1996 financial statements. Second, Defendant asserts that Plaintiffs fail to make a prima facie § 11 claim. Finally, Defendant contends that its loss causation defense bars Plaintiffs' recovery. The Court will address each argument in turn.

A. DEFENDANT'S POTENTIAL § 11 LIABILITY

Defendant first contends that its § 11 liability is limited to its December 31, 1996 audited financial statements. Plaintiffs counter that Defendant is also responsible for its unaudited 1997 quarterly statements.

Plaintiffs are wrong.

Section 11 allows securities purchasers a cause of action when a registration statement contains "an untrue statement of a material fact or omit[s] . . . a material fact." 15 U.S.C. § 77k(a). More specifically, these securities purchasers may maintain a cause of action against

> "every accountant . . . who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him[.]"

15 U.S.C. § 77k(a)(4); *see also Herman & McLean* v. *Huddleston,* 459 U.S. 375, 381-382 (1983). The Code of Federal Regulations gives clear guidance as to what constitutes "prepared or certified" for § 11 liability purposes:

> "[A] report on *unaudited* interim financial information (as defined in paragraph (d) of this section) by an independent accountant who has conducted a review of such interim financial information *shall not* be considered a part of a registration statement prepared or certified by an accountant or a report prepared or certified by an accountant *within the meaning of section 7 and 11 of the Act.*"

17 C.F.R. § 230.436(c) (emphasis supplied). As another court succinctly put it, "[t]he accountants' potential section 11 liability is limited to properly identified misleading statements in the certified financial data included in the registration statement." *McFarland* v. *Memorex Corp.,* 493

F. Supp. 631, 643 (N.D.Cal. 1980) (internal citation omitted).

In the present case, it is undisputed that the only certified, *audited* data at issue is the December 1996 financial statement.[1] Plaintiffs argue that Defendant is nonetheless liable for FPA's 1997 quarterly statements because Defendant failed to perform a "subsequent events analysis." In support of this argument, Plaintiffs cite two cases: *Escott* v. *BarChris Construction Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968), and *Shaw v. Digital Equipment Corp.*, 82 F.3d 1194 (1st Cir. 1996).

Notwithstanding Plaintiffs' reliance on other circuits' decisional law, the above-cited cases are completely inapposite to the facts here. In *Escott,* the defendant asserted a due diligence defense. In rejecting defendant's due diligence defense, the court found that the accountant "did not spend an adequate amount of time on a task of this magnitude," and "was too easily satisfied with glib answers to his inquiries." *Escott,* 283 F. Supp. at 703. The court concluded that the accounting firm "has not established its due diligence defense." *Id. Escott* thus stands for the proposition that failure to conduct a subsequent events review will prevent a defendant from successfully alleging due diligence *as a defense to* a § 11 claim; it does not provide an independent basis for § 11 liability. Here, Defendant does not raise a due diligence defense. In fact, Plaintiffs devote an entire subheading to the fact that Defendant does not, and cannot assert a due diligence

[1] *See Pl. Opp. to Mot. for SJ* at 11.

defense.[2] Because *Escott* deals with a defense not at issue in this case, Plaintiffs' argument is not well-taken.

Likewise, Plaintiffs' reliance on *Shaw* is misplaced. *Shaw* focuses exclusively on *issuer* liability under § 11, not *auditor* liability. *See Shaw*, 82 F.3d at 1200-1211. In *Shaw*, the First Circuit held that § 11 liability existed if a *registrant* failed to adhere to the duties set forth in Form S-3.[3] *Id.* at 1205. Because no auditor was named as a defendant in *Shaw*, it follows that *Shaw* cannot be used as a case establishing auditor liability under § 11. To do so would incorrectly equate an auditor's obligations and liabilities with an issuer's.[4]

In sum, Plaintiffs have failed to provide any decisional or statutory support for the proposition that anything other than *audited* financial reports subject Defendant to § 11 liability. As such, the Court finds as a matter of law that Plaintiffs' § 11 claim is limited to the audited December 31, 1996 financial statements.

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[2] *Id.* at 21 ("Notably, Deloitte does not seek to establish a defense of due diligence.")

[3] More specifically, Item 11(a), to Form S-3's instructions "requires that *the issuer (registrant)* describe in the portion of the registration statement comprising the prospectus: any and all material changes in the registrant's affairs which have occurred since the end of the latest fiscal year[.]" *Shaw*, 82 F.3d at 1205 (citing Instructions to Form S-3, Item 11(a)) (emphasis supplied).

[4] Two examples make this point clear. First, § 11(b) allows all persons, *except issuers*, the ability to prove exemption from liability. *See* 15 U.S.C. § 77k(b). Second, while accountants' liability is limited to the audited portions, "[l]iability against the issuer of a security is virtually absolute, even for innocent misstatements." *Herman & McLean*, 459 U.S. at 382.

B. SECTION 11 ANALYSIS

Having narrowed Defendant's potential liability, the Court must now determine whether Defendant is actually liable under § 11. It is undisputed that the only issue before the Court is the accounting treatment of Guaranteed Access Funds ("GAF").[5] Additionally, both parties agree that the 1996 amount at issue is $16.45 million dollars. Plaintiffs allege that these GAF payments were incorrectly characterized as revenue, and that this misstatement (or omission, depending on one's perspective) subjects Defendant to § 11 liability. Therefore, the narrow issue for the Court's resolution is this: does the improper $16.45 million dollar revenue characterization on the December 31, 1996 financial statements render Defendant liable under § 11?[6]

To establish a prima facie § 11 claim, Plaintiffs "must demonstrate (1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment." *Kaplan* v. *Rose,* 49 F.3d 1363, 1371 (9th Cir. 1954).

1. WAS DEFENDANT'S MISREPRESENTATION MATERIAL?

The key prima facie element for the Court's determination is whether the improperly recorded GAF payments

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[5] *See Pl. Opp. to Mot. for SJ* at 6-8; *Def. Mot. for SJ* at 11.

[6] Both parties agree that the 1996 amount at issue is $16.45 million dollars. (*See Richmond Decl.*, Ex. C attached thereto at 6-8 (Plaintiffs' expert report)).

were material.[7] Defendant argues that the misstatement is immaterial as a matter of law because information regarding the GAF payment accounting treatment had already entered the marketplace. Plaintiffs counter that the accounting treatment is material because Defendant decided in 1996 to recognize the entire $55 million in GAF payments through 1998, as well as the $23.7 million in shared-risk receivables associated with the Foundation transactions as revenue.

A misstated or omitted fact is material if it "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Incorporated* v. *Levinson,* 485 U.S. 224, 232 (1981) (quoting *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U.S. 438, 449 (1976)). Often, "these assessments are peculiarly ones for the trier of fact." *TSC,* 426 U.S. at 450. Only when "reasonable minds cannot differ on the question of materiality is the ultimate issue of materiality appropriately resolved as a matter of law by summary judgment." *Id.*; *see also Fecht* v. *The Price Company,* 70 F.3d 1078, 1081 (9th Cir. 1995). Although the Ninth Circuit has not expressly applied the *Basic* materiality test to §11 claims, its application nonetheless is supported by the United States Supreme Court, who stated in *Basic* that it "explicitly has defined a standard of materiality under *the securities laws.*" *Basic,* 485 U.S. at 231 (emphasis supplied). The Supreme Court has consistently applied

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[7] Defendant concedes for purposes of this motion that the GAF payments were mischaracterized as revenue. *See Def. Mot. for SJ* at 12 ("For purposes of this motion, D&T assumes that the GAF payments were improperly recorded as revenue on FPA's 1996 financial statements.") Accordingly, the Court finds as a matter of law that the first § 11 element has been satisfied.

this standard in a variety of securities litigation contexts. *See, e.g., TSC,* 426 U.S. at 449 (applying the materiality standard in a section 14(a) context); *Basic,* 485 U.S. at 232 (section 10(b) and 10b-5 context). The Ninth Circuit has applied the *Basic* standard in these same contexts. *See, e.g., Desaigoudar* v. *Meyercord,* 223 F.3d 1020 (9th Cir. 2000) (section 14(a) claim); *Provenz* v. *Miller,* 102 F.3d 1478 (9th Cir. 1996) (section 10(b) and 10b-5 claim). Because the United States Supreme Court and the Ninth Circuit have consistently applied the *Basic* materiality standard in every type of securities litigation claim, the Court finds that this standard equally applies in § 11 claims.

Having established the appropriate legal standard for materiality, the Court must now determine whether Defendant's $16.45 million dollar misstatement is immaterial as a matter of law. Several reasons compel an affirmative answer. First, the amount of misstated revenue is relatively small. In 1996, FPA reported overall revenue of $440 million dollars.[8] Therefore, the $16.45 million dollar misstatement represents a mere 3.7% of total operating revenue.[9] Also significant is the length of time between the audit date and the merger closing date. The audited financial statements ended on December 31, 1996. The merger closing date occurred on March 20, 1998 – nearly 15 months later.

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[8] *Hartley Depo.*, Ex. 16 attached thereto at 23.

[9] The $440 million is merely incorporated by reference. The historical data included in the registration statement gives an even greater total revenue – $677 million. *See Third Amended Complaint*, Ex. A at 97). Using $677 million as the total revenue, the misstatement would only be 2.4%.

Finally, the "total mix of information" available to a reasonable investor indisputably shows that: (1) FPA intended on treating GAF payments as revenue, and (2) some people disagreed with this accounting treatment. For example, FPA proxy materials filed with the SEC describe in full the nature of the GAF payments, and more importantly, that they *would be treated as revenue.*[10] Additionally, at least twenty-one analyst reports *specifically addressed the GAF accounting treatment.* Three analyst reports are worth noting. On March 14, 1997 – a full year before the merger closed – the Center for Financial Research and Analysis ("CFRA") reported that "CFRA believes that [FPA] artificially boosted its revenue and earnings with its unusual accounting for a recent acquisition . . . CFRA asserts that [FPA]'s reported revenue . . . will be overstated in every period a guaranteed access payment is received[.]"[11] On May 2, 1997 Needham & Company, Inc., issued an analyst report stating that "[t]he accounting treatment for the acquisition of the Foundation medical groups . . . has come under scrutiny."[12] Finally, Oppenheimer & Co. released a report on May 9, 1997 stating that "some investors are concerned that the $55 million in total payments to be paid back to FPA by [Foundation] over two years represent a source of inappropriate profits."[13] Based on these facts, it is indisputable that a reasonable investor had already included GAF revenue misstatements as part of the "total mix of information."

---

[10] *Beaver Report*, Ex. 7 attached thereto at 1-2.

[11] *Id.* at 3.

[12] *Id.* at 8.

[13] *Id.* at 9.

To summarize, Plaintiffs attempt to argue that a reasonable investor would consider a 3.7% misstatement in revenue occurring a year and a quarter prior to the merger closing date material. Moreover, Plaintiffs argue that the 3.7%, 15 month old misstatement significantly alters the total mix of information, when this "total mix of information" had already voluminously analyzed, published reports about and critiqued Defendant's GAF accounting treatment. To accept Plaintiffs' argument would virtually eliminate the materiality element from § 11 analysis altogether. Under Plaintiffs' view, any misstatement – no matter how attenuated or how minuscule – would be actionable under § 11. This view is completely unsupported by any authority, and the Court refuses to set such a tenuous precedent in this case.

As a last ditch effort to salvage a genuine issue of material fact, Plaintiffs argue that they never would have entered into the merger agreement had they known of the accounting misstatements. Plaintiffs' 20/20 hindsight, without more, cannot defeat summary judgment. Indeed, § 11 cases could never be decided as a matter of law if this argument sufficed. What aggrieved party wouldn't make this argument following a merger gone awry? The Court finds that no jury could reasonably conclude that there is a genuine issue of material fact as to Plaintiffs' failure to establish a prima facie § 11 claim. Summary judgment is therefore appropriate. *See Celotex,* 377 U.S. at 324.

C. DEFENDANT'S AFFIRMATIVE DEFENSES

Assuming *arguendo* that Defendant's misstatements were material, Defendant nonetheless provides a loss causation defense that mandates summary judgment.

"Loss causation exists where the misrepresentation touches upon the reasons for the investment's decline in value." *In re Worlds of Wonder Sec. Litig.*, 35 F.3d 1407, 1422 (9th Cir. 1994) (citations omitted) (hereinafter *"WOW"*). Defendants can immunize themselves from liability by proving that the stock price's decline was not caused by the material misstatement.

Section 11(e) states:

> [I]f the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement therein not misleading, such portion of or all such damages shall not be recoverable.

15 U.S.C. § 77k(e). In other words, "the burden is then on defendants to show that 'factors other than' the omissions caused the decline in the value of the stock for which plaintiffs seek to recover." *In re Fortune Sys. Sec. Litig.*, 680 F. Supp. 1360, 1364 (N.D. Cal. 1987). This burden, while heavy, is not insurmountable. *Id.* (quoting *Akerman* v. *Oryx Communications, Inc.*, 810 F.2d 336, 340 (2d Cir. 1987).

Defendant has met its burden in this case. Defendant has provided expert testimony from William Beaver, Joan E. Horngren Professor of Accounting in the Stanford University Graduate School of Business. Professor Beaver states that "the alleged accounting deficiencies, with respect to the 1996 audited financial statements, identified in the Stevens report did not cause the stock price

declines that occurred subsequent to March 20, 1998."[14] This report is based on several factors:

> (1) the marketplace knew of the GAF accounting treatment and any possible problems therefrom in early 1997;
>
> (2) FPA's historical price fluctuations indicate a rapid reaction to information;
>
> (3) the marketplace regarded FPA as a risky investment;
>
> (4) FPA's stock price was sensitive to economy-wide information; and
>
> (5) Statistical analysis correlating marketplace information to stock price.[15]

Plaintiffs argue that Professor Beaver's report actually supports Plaintiffs' position because the disclosure of the $200 million asset write-down announcement, coupled with a liquidity crisis, caused FPA's stock to plummet. Additionally, Plaintiffs argue that this case is comparable to *WOW,* where the Ninth Circuit reversed a district court's of summary judgment. A more detailed analysis of *WOW* demonstrates the flaw in Plaintiffs' reasoning.

In *WOW,* "the decline in the value of WOW's investment securities . . . corresponded precisely to a series of fiscal 1988 public disclosures." *WOW,* 35 F.3d at 1422 (internal quotes omitted). Additionally, "[t]he plaintiffs introduced expert testimony that those disclosures *directly related* to the transactions for which Deloitte allegedly

---

[14] *Richmond Decl.*, Ex. A attached thereto at 4.

[15] *Id.* at 4-6.

made erroneous accounting determinations[.]" *Id.* (emphasis in original). In other words, the plaintiffs in *WOW* created a three-part chain – (1) an accounting misstatement (2) directly related to an adverse disclosure which (3) caused the investment's decline.

Here, it is undisputed that FPA's stock precipitously declined following adverse disclosures. However, the fatal flaw in Plaintiffs' case is the inability to demonstrate how the December 1996 $16.45 million revenue misstatement directly related to the March 1998 adverse disclosures. Professor Beaver's report does not help Plaintiffs' cause, for it specifically states that this revenue discrepancy *did not* cause the FPA stock to fall. Plaintiffs' expert report also fails to provide the causal link for two additional reasons. First, Defendant's revenue recognition practices did not comply with GAAP or GAAS (a point that, for this motion's purposes, Defendant has already conceded). Second, the report makes no connection whatsoever between the aforementioned $16.45 million misstatement and the $200 million write-down.[16] Without some form of expert testimony linking these two events together, there can be no disputed facts for trial. If Plaintiffs had presented evidence suggesting that the $16.45 million misstatement caused the decline (in essence, rebutting Defendant's defense established via uncontradicted expert

[16] This failed causal connection also undermines Plaintiffs's materiality argument. According to Plaintiffs, the term "material" was defined to mean any event adversely affecting FPA by more than $50 million. *See Pl. Opp. to SJ* at 5. Here, not only was the misstatement under the $50 million threshold ($16.45 million), but Plaintiffs have failed to show that this $16.45 million misstatement had or would have had an adverse effect of more than $50 million on FPA. As such, the Court must reject this argument.

testimony), then the determination likely would have been one of credibility, which has traditionally been the province of the jury. Out of an abundance of caution, the Court granted Plaintiffs an opportunity to present further evidence and argument through a sur-reply memorandum filed with the Court on October 9, 2002. Despite this opportunity, Plaintiffs wholly failed to complete the causation chain. Accordingly, no genuine issue of material fact remains as to Defendant's loss causation defense. The defense applies and mandates summary judgment.

IV. CONCLUSION AND ORDER

In light of the foregoing, the Court GRANTS Defendant's motion for summary judgment. (Doc. No. 145-1.)

IT IS SO ORDERED.

DATE: October 17, 2002

/s/ Thomas J. Whelan
HON. THOMAS J. WHELAN
United States District Court
Southern District of California

CC: ALL PARTIES

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Case No. 99-CV-1516 LAB (AJB)
[Consolidated with 99-CV-1736-LAB (AJB)]

CHARLES T. MADDEN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE LLP, et al.

NAVIN P. AMIN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE LLP, et al.

[Filed October 21, 2003]

FINAL JUDGMENT AND ORDER OF DISMISSAL WITH PREJUDICE

This matter came before the Court on application of the parties for entry of final judgment and dismissal with prejudice pursuant to the Settlement Agreement And Release Of All Claims And Rights (the "Agreement"), dated July 8, 2003, which Agreement is attached hereto as Exhibit A. IT IS HEREBY ORDERED, ADJUDGED AND DECREED that:

1. This Judgment incorporates by reference the definitions in the Agreement, and all terms used herein shall have the same definitions as set forth in the Agreement.

2. This Judgment applies to that certain action *CHARLES T. MADDEN ET AL. V. DELOITTE AND TOUCHE ET AL.*, United States District Court Southern District of California, Case No. 99-CV-1516-LAB(AJB) (the "*Madden* Action"), and that certain action *NAVIN P. AMIN V. SG COWEN SECURITIES CORPORATION ET AL.*, United States District Court Southern District of California, Case No. 99-CV-1736-LAB(AJB) (collectively "'33 Act Cases").

3. This Court hereby dismisses with prejudice, and without costs, all claims that the '33 Act Plaintiffs brought or could have brought against Stephen Dresnick, Seth Flam, Steven Lash and James Lebovitz ("Settling Defendants") or their Related Parties in the '33 Act Cases. Upon the Effective Date, all of the '33 Act Plaintiffs, specifically Shashidhar Acharya, Achauer Family Ltd. Partnership, Angela Allevato, Navin Amin, Ragnar Amlie, Choong Baick, Robert Baird, Lawrence Barnett, Gregory Bartlow, Marjorie Baughan, Annette Bernhut-Caplin, Birbal Bhaskar, Bharat Bhimani, Jonathan Blair, Richard Bond, Daniel Boyce, Thomas Broderick, Lourdes Brown, Nancy Brownell, Dawn Lynn Bruner, Robert Budman, Alan Bures, Robert Buster, Raymond Casciari, Michael Cater, Kim James Charney, Anna Lisa Chavez, Philip Chiu, Janak/Raman Chopra, Allen Chou, Gaston Cilliani, Carmelita Co-Casquejo, William Collins, Paul Constantine, Lynn Cooper, Theodore Coutsoftides, Joseph Cummings, Leo Cummins, Constance De Silva, Himasiri De Silva, Paul Deridder, Christina Elliott, Mark Ellis, Said El-Zayat, Meigan Everts, Brian Ewald, Mark Falcone,

Martin Feldman, Mario Ficarola, Glenn Fowler, David Furnas, Stanley Galant, Edward Garr, Alan Gazzaniga, Sherwin/Bonnie Gilman, Keith Gladstein, Leon Goldberg, Lisa Gorab, Stuart Gordon, Everett Grahn, Kenneth Grubbs, Norah Gutrecht, Norman Harris, Robert Helton, David Hertsgaard, David Hicks, Thomas Hryniewicki, G.B. Huckaby, Gary Jenkins, R Judd Jessup, Stanley Kanow, Leonard Kellogg, John Kleinberg, Bedros Kojian, Edward Kravitz, Mark Krugman, Lawrence N. Kugelman, D. Sajee Lekawa, Charles Levitan, Sandra Lieberman (substituted for Melvyn B. Lieberman as Trustee for the Melvyn B. Lieberman Trust per 3/19/03 order), E. Michael Linzey, John Luster, G. Gary Mackie, Charles Madden, Alan Maderious, Tariq Mahmood, Paul Mansonhing, David Margileth, Mark Marten, P. Michael McCart, William McMaster, William Metzger, Maria Minon, Judith Monge, Ronald Moreland, James Morley, Michael Mullin, Beverly Myers, Stanley Nakamoto, Sheldon Nankin, Christopher Ohman, Kusum Ohri, Jack Osborn, James Padova, Brian Palafox, Gregory Pecchia, P. Chin Phan, James Pierog, Richard Pitts, John Prince, Joseph Raffel, Louis Rehlen, Francis Rhie, Norman Rosen, Samuel Rosenfeld, Eric Rowen, Helen Rowen, Mark Steven Rowen, Marshall Rowen, Scott Jeffrey Rowen, Herman Rundle, Carl Selin, Jeffrey Shapiro, Pravin Sharma, Hal Shimazu, Sierra Ventures V, L.P., Igal Silber, Aisha Simjee, Carole Sofio, Donald Sperling, Jack Stewart, James Strebig, James Tananbaum, Ivan Turpin, Roger Wang, Carl Weinert, Allan Weiss, Daniel Weissberg, Linda Weissberg, Laurence Wellikson, Angela Wintheiser, Allan Wong and Jerry Wu (collectively "the '33 Act Plaintiffs") shall be deemed to have, and by operation of this Judgment shall have, fully, finally, and forever released, relinquished and discharged all Released Claims against the

Settling Defendants and their Related Parties. The '33 Act Plaintiffs are hereby forever barred and enjoined from prosecuting the Released Claims against the Settling Defendants and their Related Parties.

4. Upon the Effective Date, each of the Settling Defendants shall be deemed to have, and by operation of this Judgment shall have, fully, finally, and forever released, relinquished and discharged all Released Defendants' Claims against the '33 Act Plaintiffs and their Related Parties.

5. The parties to this action (other than Deloitte & Touche LLP ("D&T"), Volpe Brown Whelan & Co., LLC ("Volpe") and S.G. Cowen Securities Corporation, successor in interest to Cowen & Company and Cowen, Inc.) and all persons who have previously settled with any of those parties, and any of their respective predecessors, successors or assigns, are hereby enjoined from instituting, commencing, prosecuting, participating in or continuing any action or proceeding, or from filing or prosecuting any claim, cross-claim or claim-over in any pending action or proceeding, however denominated, regardless of the allegations, facts, law, theories or principles on which they are based, including, but not limited to any claim for contribution or indemnity, in this Court or in any other court or tribunal, against National Union Fire Insurance Company of Pittsburgh, Pennsylvania, Foundation Health Systems, Inc. (currently known as Health Net, Inc.), the Settling Defendants and any of their respective attorneys and any other person who is or was at any time an insured person under director and officer liability insurance policies purchased by FPA Medical Management or its subsidiaries or affiliates for policy years beginning in 1995, 1996, 1997 and 1998, and any of their heirs, executors, estates,

administrators, attorneys, successors, assigns or insurers based on, relating to, or arising out of acts, omissions, facts, occurrences, transactions, allegations or causes of action that were or could have been asserted by the '33 Act Plaintiffs. Accordingly those claims are hereby forever and finally barred, released and extinguished.

6. Neither the Agreement nor the settlement contained therein, nor any act performed or document executed pursuant to or in furtherance of the Agreement: (i) is or may be deemed to be or may be used as an admission of, or evidence of, the validity of any Released Claims or Releases Defendants' Claims or of any wrongdoing or liability of the Released Persons, or (ii) is or may deemed to be or may be used as an admission of, or evidence of, any fault or omission of any of the Released Persons in any civil, criminal or administrative proceeding in any court, administrative agency or other tribunal. The Released Persons may file the Agreement and/or the Judgment from this action in any other action that may be brought against them in order to support a defense or counterclaim based on principles of *res judicata,* collateral estoppel, release, good faith settlement, judgment bar or reduction or any theory of claim preclusion or issue preclusion or similar defense or counterclaim.

7. The Court previously granted the motion for summary judgment by Volpe on August 2, 2002 and denied Plaintiffs' motion to alter or amend the judgment on August 14, 2002. The Court also previously granted the motion for summary judgment by D&T on October 17, 2002 and denied Plaintiffs' *ex parte* application for leave to file a motion for reconsideration on March 4, 2003. Although the Court certified its summary judgment orders for interlocutory appeal pursuant to FRCP 54(b) and

Plaintiffs filed notices of appeal, the Ninth Circuit has accepted only Plaintiffs' appeal with respect to D&T, dismissing Plaintiffs' appeals with respect to Volpe without prejudice pending entry of a final judgment as to all parties and all claims. The Court finds, in light of its prior summary judgment orders and the settlement of Plaintiffs' claims against the Settling Defendants, that this Judgment constitutes a final judgment adjudicating all the claims and the rights and liabilities of all the parties to this action. The Court directs the Clerk to enter this Judgment accordingly. Nothing in this Judgment shall be deemed to change the terms of the Courts' prior orders granting summary judgment to Volpe or D&T or to affect Plaintiffs' rights to pursue their appeals with respect to Volpe and D&T.

8. If the Effective Date, as defined in the Agreement, does not occur, this judgment and order of dismissal shall be void and without effect.

9. Without affecting the finality of this Judgment in any way, this Court hereby retains continuing jurisdiction for the purpose of administering and effecting the settlement provided for herein and in the Agreement including, without limitation, jurisdiction to enforce the payment of claims as provided in the Agreement.

IT IS SO ORDERED.

DATED: 10-20-03

/s/ Larry A. Burns
THE HONORABLE LARRY A. BURNS
UNITED STATES DISTRICT
COURT JUDGE

SETTLEMENT AGREEMENT AND RELEASE OF ALL CLAIMS AND RIGHTS

This settlement agreement (the "Agreement") is entered into this 8th day of July 2003 between, on the one hand, (i) plaintiffs in that certain action *CHARLES T. MADDEN ET AL. V. DELOITTE AND TOUCHE ET AL.*, United States District Court Southern District of California, Case No. 99-CV01516-W(AJB) (the "*Madden* Action"), and (ii) plaintiffs in that certain action *NAVIN P. AMIN V. SG COWEN SECURITIES CORPORATION ET AL.*, United States District Court Southern District of California, Case No. 99-CV-1736-W(AJB) (The "*Amin* Action," and collectively with the *Madden* Action, the "'33 Act Cases"), by and through their respective counsel, and, on the other hand, Stephen Dresnick, Seth Flam, Steven Lash, and James Lebovitz (collectively, the "Settling Defendants"). Plaintiffs in the *Madden* and *Amin* Actions are referred to herein as the "*Madden* Plaintiffs" and "*Amin* Plaintiffs" respectively, and collectively as the "'33 Act Plaintiffs". The '33 Act Plaintiffs and the Settling Defendants are sometimes referred to herein individually as "Party" and collectively as the "Parties." This Agreement is effective on the date of the last signature below and is based on the following recitals and mutual promises.

WHEREAS, the Parties wish to resolve the pending disputes between them and to compromise their claims and rights against each other.

NOW THEREFORE, in exchange for the mutual promises set forth herein, and for other good and valuable consideration, the sufficiency of which is hereby acknowledged, the Parties hereby agree as follows:

DEFINITIONS

"Related Parties" means a person or entity's past or present directors, officers, managers, employees, partners, members, principals, agents, insurers, underwriters (except for Volpe Brown Whelan & Co., LLC, hereafter "Volpe"), controlling shareholders, attorneys, accountants or auditors (except Deloitte & Touche LLP, hereafter "D&T"), banks or investment bankers (except Volpe), associates, personal or legal representatives, predecessors, successors, parents, subsidiaries, divisions, joint ventures, assigns, spouses, heirs, employers, related or affiliated entities, any entity in which the person or entity has a controlling interest, any partnership to which the person or entity belongs, any member of the person or entity's immediate family or any trust of which the person or entity is the settlor or which is for the benefit of the person or entity and/or member(s) of his or her family. In addition, for the Settling Defendants, Related Parties means Foundation Health Systems, Inc. (currently known as Health Net, Inc.) ("Foundation") and, for each, their Related Parties.

"Released Claims" means all claims (including "Unknown Claims" as defined herein), demands, rights, liabilities and causes of action of every nature and description whatsoever, known or unknown, whether or not concealed or hidden, that were or could have been alleged by the '33 Act Plaintiffs against the Settling Defendants or their Related Parties in the '33 Act Cases.

"Released Defendants' Claims" means all claims (including "Unknown Claims" as defined herein), demands, rights, liabilities and causes of action of every nature and description whatsoever, known or unknown,

whether or not concealed or hidden, that were or could have been alleged by the Settling Defendants against the '33 Act Plaintiffs or their Related Parties in the '33 Act Cases or that relate in way to the '33 Act Cases or their institution, prosecution, or settlement.

"Released Persons" means the '33 Act Plaintifs, the Settling Defendants and each of the '33 Act Plaintiffs' and the Settling Defendants' Related Parties.

"Unknown Claims" means any claim which a Party does not know or suspect to exist in his, her or its favor at the time of the release of the Released Persons which, if known by him, her or it, might have affected his, her or its settlement with and release of the Released Persons. The Parties stipulate and agree that they expressly waive and relinquish, to the fullest extent permitted by law, the provisions, rights and benefits of California Civil Code Section 1542, which provides:

> A GENERAL RELEASE DOES NOT EXTEND TO CLAIMS WHICH THE CREDITOR DOES NOT KNOW OR SUSPECT TO EXIST IN HIS FAVOR AT THE TIME OF EXECUTING THE RELEASE, WHICH IF KNOWN BY HIM MUST HAVE MATERIALLY AFFECTED HIS SETTLEMENT WITH THE DEBTOR.

The Parties also expressly waive any and all provisions, rights and benefits conferred by any law of any state or territory of the United States, or principle of common law, which is similar, comparable and equivalent to California Civil Code Section 1542. The Parties may hereafter discover facts in addition to or different from those which they now know or believe to be true, but the Parties shall expressly fully, finally, and forever settle and release any

and all Released Claims and Released Defendants' Claims, known or unknown, suspected or unsuspected, contingent or non-contingent, whether or not concealed or hidden, which now exist, or heretofore may have existed upon any theory of law or equity now existing or coming into existence in the future, including, but not limited to, conduct which is negligent, intentional, with or without malice, or a breach of any duty, law or rule, without regard to the subsequent discovery or existence of such different or additional facts.

AGREEMENT

1. No later than April 15, 2003, the Settling Defendants shall caused to be paid into an interest bearing escrow fund the amount of $4,888,888.88 for the *Madden* Plaintiffs and $1,222,222.22 for the *Amin* Plaintiffs.

2. From the escrow fund the following amounts will be paid: (a) $4,888,888.88 plus accrued interest accrued from April 15, 2003 to counsel for the *Madden* Plaintiffs, and (b) $1,222,222.22 plus accrued interest accrued from April 15, 2003 to counsel for the *Amin* Plaintiffs, each upon the occurrence of all of the following (the "Effective Date"):

(i) The judgment approving settlement of that certain litigation *In re FPA MEDICAL MANAGEMENT INC. SECURITIES LITIGATION*, United States District Court Southern District of California, Case No. 98-CV-0928-L(AJB) (the "Class Action"), becomes final and the time for appeal of that judgment has passed;

(ii) The judgment approving settlement of, and dismissing with prejudice all claims that were or could

have been brought in that certain litigation *JOSEPH PARDO, Trustee v. SHELDON DEREZIN et al.*, United States District Court for the District of Delaware, Civil Action No. 01-107 UNA (Bankruptcy # 98-1596 (PJW)) (the "Trustee Case"), becomes final; and

(iii) All claims that were or could have been brought against the Settling Defendants in the '33 Act Cases are dismissed with prejudice and final judgment substantially in the form of Exhibit A attached hereto (the "Final Judgment") is entered. The Final Judgment shall be filed with the Court upon the entry of an order in the Class Action finally approving the Class Action settlement.

3. If, at the termination, including any appeal, of the federal criminal case against Steven M. Lash entitled *United States v. Lash*, Case No. 02CR0366-J, any funds remain from the $1,000,000 set aside for the defense costs of that action accrued after December 31, 2002, that amount will be applied to any unpaid defense costs, and thereafter any remaining amount will be paid as follows: 4/9 to counsel for the *Madden* Plaintiffs, 1/9 to counsel for the *Amin* Plaintiffs, and 4/9 to counsel for the Class Action plaintiffs.

4. The '33 Act Plaintiffs will not be entitled to participate in the Class Action settlement. Counsel for Plaintiffs in the '33 Act cases shall be responsible for any allocation of settlement proceeds to attorney fees and expenses and for all distributions to their respective clients.

5. Counsel for the '33 Act Plaintiffs represent and warrant that no court approval or further consent or authorization from any party is required for settlement of

the '33 Act Cases and that Counsel has written authorization from each of the '33 Act Plaintiffs to enter into this Agreement on their behalf.

6. This Agreement shall not affect '33 Act Plaintiffs' claims against D&T, Volpe, and S.G. Cowen Securities Corporation, successor in interest to Cowen & Company and Cowen Inc. (collectively "Cowen") in the '33 Act Cases.

7. The Settling Defendants shall bear their own fees and costs in connection with the '33 Act Cases.

8. The '33 Act plaintiffs agree to a contribution bar in favor of Settling Defendants which will preclude any claims for contribution or equitable indemnity against the Settling Defendants by any other current or former defendant to the '33 Act Cases (except D&T, Volpe or Cowen) in accordance with the principles set forth in *Franklin v. Kaypro Corp.*, 884 F.2d 1222 (9th Cir. 1989) ("*Kaypro*"), or other applicable law or statute, with the intent that any liability eventually adjudged against D&T, Volpe or Cowen will be joint and several rather than proportionate as set forth in *Kaypro*. The Parties agree to the following contribution bar to be entered by the Court: "The parties to this action (other than D&T, Volpe or Cowen) and all persons who have previously settled with any of those parties, and any of their respective predecessors, successors or assigns, are hereby enjoined from instituting, commencing, prosecuting, participating in or continuing any action or proceeding, or from filing or prosecuting any claim, cross-claim or claim-over in any pending action or proceeding, however denominated, regardless of the allegations, facts, law, theories or principles on which they are based, including, but not limited to any claim for contribution or indemnity, in this Court or in any other court or tribunal,

against National Union Fire Insurance Company of Pittsburgh, Pennsylvania, Foundation, the Settling Defendants and any of their respective attorneys and any other person who is or was at any time an insured person under director and officer liability insurance policies purchased by FPA Medical Management or its subsidiaries or affiliates for policy years beginning in 1995, 1996, 1997 and 1998, and any of their heirs, executors, estates, administrators, attorneys, successors, assigns or insurers based on, relating to, or arising out of acts, omissions, facts, occurrences, transactions, allegations or causes of action that were or could have been asserted by the '33 Act Plaintiffs in the '33 Act Cases. Accordingly those claims are hereby forever and finally barred, released and extinguished."

9. The Settling Defendants agree to extend reasonable procedural cooperation to all parties in connection with the remaining claims in the '33 Act Cases; provided that nothing in this Agreement shall require any individual to testify at any proceeding where he is not otherwise subject to subpoena, or to waive his Fifth Amendment privilege against self-incrimination.

10. Upon the Effective Date, the '33 Act Plaintiffs shall be deemed to have, and by operation of the Final Judgment shall have, fully, finally and forever released, relinquished and discharged all Released Claims against the Settling Defendants, and each of them, and their Related Parties.

11. Upon the Effective Date, the Settling Defendants shall be deemed to have, and by operation of the Final Judgment shall have, fully, finally and forever released, relinquished and discharged all Released Defendants'

Claims against the '33 Act Plaintiffs, and each of them, and their Related Parties.

12. This Agreement shall be binding upon and inure to the benefit of the respective Parties hereto, their successors, assigns, agents, insurers, employees, attorneys, corporate parents, corporate subsidiaries, partnerships and representatives.

13. This Agreement memorializes and constitutes the entire Settlement Agreement and Release of All Claims between the Parties, and there are no other agreements modifying its terms. The terms of this Agreement can only be modified in writing.

14. The Parties to this Agreement hereby agree that it may be executed and signed in counterpart.

15. In any dispute arising under this Agreement, the prevailing party shall be entitled to attorneys' fees and costs, including all expenses reasonably necessary and actually incurred by the prevailing party.

16. If any provision of this Agreement is held to be invalid, void or unenforceable, the remaining provisions shall remain in full force and effect.

17. This Agreement is entered into, and shall be construed and interpreted in accordance with, the laws of the State of California.

APPROVED AND AGREED:
Dated: 7/17/03

LATHAM & WATKINS LLP

By: /s/ Julia E. Parry
Julia E. Parry
Attorneys for the Individual Defendants

Dated: July 10, 2003

BOROWSKY & HAYES LLP

By: /s/ Philip Borowsky
Philip Borowsky
Attorneys for the Madden Plaintiffs

Dated: July 17, 2003

ENGSTROM, LIPSCOMB & LACK, P.C.
GIRARDI & KEESE

By: /s/ Steven Shuman
Steven Shuman
Attorneys for the Amin Plaintiffs

APPENDIX E

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT
Southern District of California, San Diego

No. 02-56976
D.C. No. CV-99-01516-TJW

CHARLES T. MADDEN; et al., Plaintiffs, and
NAVIN P. AMIN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE LLP, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

No. 02-56982
D.C. No. CV-99-01516-TJW

CHARLES T. MADDEN; et al., Plaintiffs-Appellants, and
NAVIN P. AMIN; et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

No. 03-55408
D.C. No. CV-99-01516-TJW

CHARLES T. MADDEN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE, Defendant-Appellee, and
VOLPE BROWN WHELAN & COMPANY; et al., Defendants.

No. 03-56891

D.C. No. CV-99-01516-LAB

CHARLES T. MADDEN; et al., Plaintiffs-Appellants,

v.

DELOITTE & TOUCHE; et al., Defendants, and
VOLPE BROWN WHELAN & COMPANY, Defendant-Appellee.

[Filed: February 4, 2005]

ORDER

Before: FERNANDEZ, SILVERMAN, and CALLAHAN, Circuit Judges.

The panel has voted to deny appellants' petition for rehearing. Judges Silverman and Callahan have voted to reject the petition for rehearing en banc and Judge Fernandez so recommends.

The full court has been advised of the petition for rehearing en banc and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R. App. P. 35.

The petition for rehearing and the petition for rehearing en banc are denied.

APPENDIX F

15 U.S.C. § 77b (Securities Act of 1933, Section 2). Definitions; promotion of efficiency, competition, and capital formation

(a) Definitions

When used in this subchapter, unless the context otherwise requires –

* * *

(8) The term "registration statement" means the statement provided for in section 77f of this title, and includes any amendment thereto and any report, document, or memorandum filed as part of such statement or incorporated therein by reference.

* * *

15 U.S.C. § 77g (Securities Act of 1933, Section 7). Information required in registration statement

(a) * * * If any accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, is named as having prepared or certified any part of the registration statement, or is named as having prepared or certified a report or valuation for use in connection with the registration statement, the written consent of such person shall be filed with the registration statement. * * *

* * *

15 U.S.C. § 77k (Securities Act of 1933, Section 11). Civil liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue –

* * *

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

* * *

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof –

* * *

(3) That * * * (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; * * *

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required for a prudent man in the management of his own property.

* * *

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference

between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided,* That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a materia fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. * * *

* * *

15 U.S.C. § 77*l* (Securities Act of 1933, Section 12). Civil liabilities arising in connection with prospectuses

(a) In general

Any person who –

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the

exercise of reasonable care could not have known, of such untruth or omission,

shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

(b) Loss causation

In an action described in subsection (a)(2) of this section, if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

* * *

15 U.S.C. § 78n (Securities Exchange Act of 1934, Section 14). Proxies

(a) Solicitation of proxies in violation of rules and regulations

It shall be unlawful for any person, by the use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, in contravention of such rules and regulations as the Commission may prescribe as necessary

or appropriate in the public interest or for the protection of investors, to solicit or to permit the use of his name to solicit any proxy or consent or authorization in respect of any security (other than an exempted security) registered pursuant to section 78*l* of this title.

* * *

17 C.F.R. § 240.14a-9 (SEC Rule 14a-9).

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

* * *

APPENDIX G
(DISTRICT COURT'S THIRD AMENDED COMPLAINT)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. 99-CV-1516 W (AJB)

CHARLES T. MADDEN, an individual, et al., Plaintiffs,

v.

DELOITTE & TOUCHE LLP, et al., Defendants.

NAVIN P. AMIN, an individual, et al., Plaintiffs,

v.

DELOITTE & TOUCHE,
a limited liability partnership, Defendants.

[Filed March 15, 2001]

CONSOLIDATED THIRD AMENDED COMPLAINT FOR VIOLATION OF SECTIONS 11, 12, AND 15 OF THE SECURITIES ACT OF 1933, 15 U.S.C. §§ 77K, 77L, AND 77O

[Body of complaint omitted in printing.]

EXHIBIT A

As filed with the Securities and Exchange Commission on February 11, 1998.

Registration No. 333-46031.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM S-4

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

FPA MEDICAL MANAGEMENT, INC.

[Remainder of caption omitted in printing]

* * *

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* * *

The shares of FPA Common Stock to be received in exchange for the OCMCS Common Stock, the OCMCS Preferred Stock and the OCMCS Options (except as otherwise provided in the Merger Agreement) shall be contractually restricted from sale, transfer or other disposition for a period of 90 days commencing as of the Effective Time.

To the extent that FPA, FPA California, SJMC or OCMCS waives compliance with material provisions of or conditions to consummation of the Combined Merger, FPA, FPA California, SJMC and OCMCS will amend this Proxy

Statement/Prospectus, and SJMC and OCMCS will resolicit stockholder votes to the extent required by law.

This Proxy Statement/Prospectus and the accompanying forms of proxy are first being mailed to shareholders of SJMC and stockholders of OCMCS on or about , 1998.

This Proxy Statement/Prospectus also constitutes the Prospectus of FPA filed as part of a Registration Statement on Form S-4 (the "Registration Statement") with the Securities and Exchange Commission (the "Commission") under the Securities Act of 1933, as amended (the "Securities Act"), relating to the shares of FPA Common Stock to be issued to shareholders of SJMC and stockholders of OCMCS in the Combined Merger.

No persons have been authorized to give any information or to make any representation other than those contained in this Proxy Statement/Prospectus in connection with the solicitation of proxies or the offering of securities made hereby and, if given or made, such information or representation should not be relied upon as having been authorized by FPA, FPA California, SJMC or OCMCS. This Proxy Statement/Prospectus does not constitute an offer to sell, or the solicitation of an offer to purchase, any securities, or the solicitation of a proxy, in any jurisdiction in which, or to any person to whom, it is unlawful to make such offer or solicitation of an offer or proxy solicitation. Neither the delivery of this Proxy Statement/Prospectus nor any distribution of the securities offered hereby shall, under any circumstances, create any implication that there has been no change in the affairs of FPA, FPA California, SJMC or OCMCS since the date hereof or that the information set forth or incorporated by reference herein is correct as of any time subsequent to

its date. All information herein with respect to FPA and FPA California has been furnished by FPA, all information herein with respect to SJMC has been furnished by SJMC, and all information herein with respect to OCMCS has been furnished by OCMCS.

Available Information

FPA is subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and, in accordance therewith, files reports, proxy statements and other information with the Securities and Exchange Commission (the "Commission"). Such reports, proxy statements and other information may be inspected and copied at the offices of the Commission, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549, and the Regional Offices of the Commission: Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661 and 7 World Trade Center, Suite 1300, New York, New York 10048. Copies of such materials may be obtained from the Public Reference Section of the Commission at Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates or from the Commission's Internet Web site at http://www.sec.gov. Shares of FPA Common Stock are traded on the Nasdaq National Market System under the symbol FPAM. Reports and other information concerning the registrant may be inspected at the Nasdaq National Market.

FPA has filed with the Commission a registration statement (the "Registration Statement") under the Securities Act of 1933, as amended (the "Securities Act"), on Form S-4 with respect to the securities offered hereby.

This Proxy Statement/Prospectus also constitutes the Prospectus of FPA filed as part of the Registration Statement and does not contain all of the information set forth in the Registration Statement and the exhibits thereto, certain parts of which are omitted in accordance with the rules of the Commission. Statements made in this Proxy Statement/Prospectus as to the contents of any contract, agreement or other document referred to are not necessarily complete; with respect to each such contract, agreement or other document filed as an exhibit to the Registration Statement, reference is made to the exhibit for a more complete description of the matter involved, and each such statement shall be qualified in its entirety by such reference. The Registration Statement and any amendments thereto, including exhibits filed as part thereof, are available for inspection and copying at the Commission's offices as described above.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The following documents, which have been filed by FPA (File No. 0-24276) with the Commission pursuant to the Exchange Act, are incorporated by reference in this Proxy Statement/Prospectus:

1. FPA's Annual Report on Form 10-K for the fiscal year ended December 31, 1996 filed with the Commission on March 31, 1997, as amended by Form 10-K/A filed with the Commission on April 29, 1997.

2. FPA's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 filed with the Commission on May 15, 1997.

3. FPA's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997 filed with the Commission on August 14, 1997.

4. FPA's Quarterly Report on Form 10-Q for the quarter ended September 30, 1997 filed with the Commission on November 14, 1997.

5. FPA's Current Report on Form 8-K dated March 17, 1997 filed with the Commission on May 16, 1997, as amended by Form 8-K/A filed with the Commission on May 28, 1997.

6. FPA's Current Report on Form 8-K dated July 31, 1997 filed with the Commission on July 31, 1997, as amended by Form 8-K/A filed with the Commission on October 10, 1997.

7. The audited combined balance sheets of Foundation Health Medical Services (a wholly owned subsidiary of Foundation Health Corporation) and affiliates as of June 30, 1995 and 1996 and the related combined statements of operations, shareholders' deficit and cash flows for each of the three years in the period ended June 30, 1996 contained in FPA's Registration Statement on Form S-4 dated February 13, 1997.

8. FPA's Current Report on Form 8-K dated December 9, 1997 filed with the Commission on December 10, 1997.

9 The description of the FPA Common Stock contained in FPA's Registration Statement on Form 8-A dated October 20, 1994.

All documents and reports subsequently filed by FPA pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this Proxy Statement/Prospectus and prior to the date of the OCMCS and SJMC Special Meetings shall be deemed to be incorporated by reference in this Proxy Statement/Prospectus and to be a part hereof from the date of filing of such documents or reports. Any statement contained in a document incorporated or deemed to be incorporated by reference herein shall be deemed to be modified or superseded for purposes of this Proxy Statement/Prospectus to the extent that a statement contained herein or with respect to FPA in any other subsequently filed document which also is or is deemed to be incorporated by reference herein modifies or supersedes such statement. Any such statement so modified or superseded, except as so modified or superseded, shall not be deemed to constitute a part of this Proxy Statement/Prospectus.

This Proxy Statement/Prospectus incorporates documents by reference which are not presented herein or delivered herewith. Such documents (other than exhibits to such documents, unless such exhibits are specifically incorporated by reference) are available to any person, including any beneficial owner, to which this Proxy Statement/Prospectus is delivered, without charge, on written or oral request directed to FPA Medical Management, Inc., 3636 Nobel Drive, Suite 200, San Diego, California 92122, Attention: James A. Lebovitz (telephone number (619) 453-1000). In order to ensure timely delivery of the documents, any request should be made by , 1998, the date which is five business days prior to the date of the SJMC and OCMCS Special Meetings.

* * *

SUMMARY

The following is a summary of certain information contained elsewhere or incorporated by reference in this Proxy Statement/Prospectus. The information contained in this summary is qualified in its entirety by, and should be read in conjunction with, the detailed information and financial statements, including the notes thereto, appearing elsewhere in this Proxy Statement/Prospectus and the documents incorporated herein by reference.

FPA MEDICAL MANAGEMENT, INC.

FPA is a national physician practice management company which acquires, organizes and manages primary care physician practice networks and provides contract management services to hospital-based emergency departments. FPA provides primary and specialty care services to prepaid managed care enrollees and fee-for-service patients through a network of independent practice association physicians and owned primary care physician groups. FPA manages all covered primary and specialty medical care for each enrollee in exchange for monthly capitation payments pursuant to Payor contracts. Under certain Payor contracts, certain of FPA's subsidiaries and Professional Corporations also accept the financial risk for hospital services. FPA is affiliated with approximately primary care physicians (including emergency room physicians), who provide services to approximately enrollees of health maintenance organizations ("HMOs") or other prepaid health insurance plans (collectively, "Payors") in states. FPA, through its subsidiary Sterling Healthcare Group, Inc. ("Sterling"), provides management services pursuant to approximately contracts to hospital emergency

departments, urgent care, radiology and correctional facilities.

FPA's strategy is to increase enrollment by adding new Payor relationships and new providers to the existing FPA Network and by expanding the FPA Network into new geographic areas where the penetration of managed healthcare is growing. FPA believes new Payor and provider relationships are possible because of its ability to manage the cost of health care without sacrificing quality. FPA seeks to control the two "gatekeeping" points of entry into the managed health care delivery system – the primary care physician's office and the emergency room – thereby giving FPA a platform for coordinating all aspects of patient care under global capitation Payor contracts. FPA is also pursuing national and multi-state Payor contracts, which facilitate more rapid development of provider networks in new markets and thus should enable FPA to increase enrollment in an accelerated manner. FPA or certain of its subsidiaries have recently entered into multi-state Payor contracts with NYLCare Health Plans, Oxford Health Plans, WellPoint Health Network, Inc., PacifiCare Health Systems, Inc., Aetna U.S. Healthcare and Foundation Health Systems, Inc. whereby the FPA Network will be accessible to certain members of each of the Payors in agreed upon geographic areas.

FPA's relationships with its subsidiaries and affiliated professional corporations (the "Professional Corporations"), other providers of medical services and Payors (collectively, the "FPA Network") offer physicians the opportunity to participate more effectively in managed care programs by organizing physician groups within geographic areas to contract with Payors. FPA enhances physician practice operations by assuming administrative

functions necessary in a managed care environment. These functions include claims adjudication, utilization management of medical services, Payor contract negotiations, credentialing, financial reporting and the operation of management information systems. Under these arrangements, FPA, on behalf of the Professional Corporations, is responsible for the payment of the cost of medical services, including professional, ancillary and medical management services, and is entitled to amounts received from Payors in excess of such costs. FPA believes that its management model is appealing to physicians because it allows the physicians to retain control of their own practices while gaining access to more patients through participation in a managed care program.

Except where otherwise permitted by law or regulation, FPA does not engage in the practice of medicine. Due to the constraints of the corporate practice of medicine doctrine, FPA cannot own the majority of shares of the voting stock of the Professional Corporations in most states. FPA has direct or indirect unilateral and perpetual control over the assets and operations of the Professional Corporations which are consolidated with FPA through the ownership of such Professional Corporations by certain physicians who are employees of FPA or one of its subsidiaries. Each stockholder/director of such Professional Corporations has entered into a succession agreement with FPA which requires such stockholder/director to sell to a designee of FPA such stockholder/director's shares of stock in the relevant Professional Corporation for a nominal amount if such stockholder/director is terminated from employment with FPA.

Agreements with Payors and providers are entered into with, and approved by, either a subsidiary of FPA or

one of the Professional Corporations, depending on applicable state law. In the states where the corporate practice of medicine doctrine prohibits the ownership of professional corporations other than by physicians or physician-owned professional corporations, in most cases the capitation payments are received by the Professional Corporations and are generally assigned to FPA pursuant to administrative services agreements. Where subsidiaries of FPA contract directly with Payors, such subsidiaries receive the capitation payments.

The FPA Network manages all covered primary and specialty medical care for each enrollee in exchange for monthly capitation payments pursuant to Payor contracts. Specialty care physician services, inpatient hospitalization and certain other services managed by primary care physicians are subject to pre-authorization guidelines and are provided through contracts negotiated by FPA for the Professional Corporations based on discounted fee-for-service, per diem or capitation rates. Contracts with Payors and primary care physicians generally include shared risk arrangements and other incentives designed to encourage the provision of high-quality, cost-effective health care. Under certain Payor contracts, certain of FPA's subsidiaries and Professional Corporations also accept the financial risk for hospital services. Because the Professional Corporations and certain of FPA's subsidiaries are obligated to provide medical services, some of the costs of which are variable, for fixed capitation fees, FPA's profitability may vary based on the ability of FPA and its affiliated providers to control such health care costs.

FPA recruits physicians and contracts for their services to provide staffing of emergency departments. FPA also assists its hospital clients in such areas as physician

scheduling, operations support, quality assurance and departmental accreditation as well as billing and record keeping. In addition, FPA has expanded its hospital-based services to include the management of anesthesiology departments and rural health care clinics.

The future growth of FPA is largely dependent on a continued increase in the number of new enrollees in the FPA Network. This growth may come from (i) affiliations with, or acquisitions of, individual or group physician practices serving enrollees of Payors in the FPA Network or of new Payors, (ii) increased membership in plans of Payors with which the Professional Corporations or subsidiaries of FPA have contracts and whose members are patients of physicians in the FPA Network or (iii) agreements with Payors, physicians and hospitals in other geographic markets. The process of identifying and consummating suitable acquisitions of, or affiliations with, physician groups can be lengthy and complex. The environment for such acquisitions and affiliations is subject to increasing competitive pressures. There can be no assurance that FPA will be successful in identifying, acquiring or affiliating with additional physician groups or hospitals or that the Professional Corporations or subsidiaries of FPA will be able to contract with new Payors. In addition, there can be no assurance that FPA's acquisitions will be successfully integrated on a timely basis or that the anticipated benefits of these acquisitions will be realized; failure to effectively accomplish the integration of acquired entities may have a material adverse effect on FPA's results of operations and financial condition. FPA's ability to expand is also dependent upon its ability to comply with legal and regulatory requirements in the jurisdictions in

which it operates or will operate and to obtain necessary regulatory approvals, certificates and licenses.

FPA is regularly in discussions with potential acquisition candidates and may from time to time enter into letters of intent or definitive agreements with respect to the acquisition of such businesses. There can be no assurance that FPA will acquire any additional businesses.

The health care industry is subject to extensive federal and state legislation and regulation. Changes in the regulations or interpretations of existing regulations could significantly affect the business of FPA.

FPA's executive offices are located at 3636 Nobel Drive, Suite 200, San Diego, California 92122 and its telephone number is (619) 453-1000.

FPA Recent Developments. FPA entered into an Agreement and Plan of Merger dated February 10, 1998 between FPA and Meridian Medical Group, Inc., a Georgia professional corporation ("Meridian"), whereby Meridian will merge with and into FPA. Meridian is a primary care medical group which employs approximately 55 physicians who provide healthcare services to approximately 67,900 managed care members at nine clinics in the Atlanta, Georgia area. FPA anticipates that the merger will be consummated in the second quarter of 1998 and is subject to Meridian shareholder approval, regulatory approval and other customary closing conditions.

For more information regarding FPA and the Combined Merger, see "SELECTED HISTORICAL AND PRO FORMA INFORMATION" and "SELECTED HISTORICAL FINANCIAL DATA – FPA."

ST. JOSEPH MEDICAL CORPORATION AND ORANGE COAST MANAGED CARE SERVICES, INC.

Orange Coast Managed Care Services, Inc. ("OCMCS") is a physician practice management company headquartered in Orange County, California. OCMCS provides a wide range of medical management services, organizational development and contracting support to St. Joseph Medical Corporation, a California professional corporation ("SJMC"), including administrative support to St. Joseph IPA, an independent practice association ("SJIPA"), and St. Joseph Medical Group, a primary care medical group ("SJMG"), in the areas of network development, provider contracting, claims processing, financial management, management information systems, quality management, utilization management and grievance resolution, billing and collections and medical office support services. SJMC operates two divisions: SJIPA and SJMG. A third division, the occupational medicine division, was sold effective as of September 30, 1997 to U.S. Healthworks of California, Inc., an affiliate of U.S. Healthworks, Inc. SJMC owns approximately 70% of the OCMCS Voting Securities.

SJMC was formed in 1992 as the result of a merger between St. Joseph Multi-Specialty Group, Inc. and Saint Joseph Hospital Medical Group. OCMCS was formed as a Delaware corporation on November 9, 1995. In December 1995, OCMCS and SJMC restructured their operations and entered into a 50 year management services agreement (the "MSA"), whereby OCMCS provides the management and administrative services, as described above, to SJIPA and SJMG. SJMC retains exclusive control over the medical aspects of its operations.

SJIPA operates a physician network in Orange County, California, which provides health care services to members of various Payors, including preferred provider organizations. As of December 1997, SJIPA had contracts with Payors to provide medical care to approximately 129,000 members (120,200 commercial/point of service members and 8,800 Medicare members). SJIPA's network of providers includes more than 580 physicians, of whom approximately 190 are primary care physicians.

SJMG delivers primary medical care through nine clinics located in central Orange County. SJMG employs approximately 48 primary care physicians to provide services to approximately 54,800 managed care members as of December 31, 1997. SJMG is SJIPA's largest primary care provider. SJMG currently provides medical services to approximately 50,100 of SJIPA's 129,000 HMO members, as well as a comparable number of fee-for-service patients. SJMG also provides primary medical care services to nearly 4,700 IPA members who are not affiliated with SJIPA. SJMG was formed in late 1994 and is the result of a combination of the practices of approximately 40 primary care physicians representing a wide range of primary care disciplines (pediatrics, family practice and internal medicine) and located in central Orange County, California.

The executive offices of OCMCS and SJMC are located at 505 South Main Street, Suite 200, Orange, California 92868, and their telephone number is (714) 560-5000.

* * *

THE COMBINED MERGER

Background of the Combined Merger

FPA

FPA's strategy for enhancing long-term value for its stockholders has been to increase the number of enrollees and primary care physicians in the FPA Network and to negotiate favorable contracts with Payors to provide physician and related health care services to enrollees who select FPA primary care physicians. The FPA Board believes that by doing so, FPA can enhance revenues and earnings. FPA has grown significantly as a result of acquisitions. The FPA Board periodically reviews various strategic opportunities to enhance profitability and increase stockholder value. In this regard, the FPA Board continually evaluates the acquisition of other entities and medical practices and has considered longer term acquisition opportunities and other strategic alternatives. The FPA Board determined that the Combined Merger would enhance FPA by expanding the geographic scope of its California operations into Orange County, by increasing its provider and Payor contracts in California and by adding approximately 129,000 additional managed care lives to its operations.

SJMC and OCMCS

During 1996 and early 1997, OCMCS and SJMC were exploring opportunities for enhancing their operations in Orange County, California and expanding operations elsewhere through possible acquisitions, joint ventures, contractual arrangements and other arrangements. In the course of considering these various alternatives, OCMCS and SJMC management was made aware of strong informal interest by several entities as to the possible purchase

of OCMCS and SJMC. While the stated business plan of OCMCS and SJMC at such time was to remain independent and to continue to grow their respective businesses, OCMCS and SJMC had been unsuccessful in the prior year in consummating a large potential acquisition and had not been able to meet certain of the material objectives of their business plan by the late Spring of 1997. It further had become clear by such time from the various preliminary joint venture discussions undertaken by OCMCS that OCMCS would not likely be able to enter into a significant joint venture transaction without limiting its autonomy and/or limiting in some manner further appreciation of stockholder value. OCMCS and SJMC also witnessed during the preceding two years the acquisition of competitive medical groups by a medical foundation affiliated with SJHO, SJMC's primary hospital and a stockholder of OCMCS, the consolidation of competitive provider groups by MedPartners, Inc. within the Orange County area, the consolidation of previously competitive hospitals by certain of the large hospital companies, and the continuing consolidation of HMOs in California.

In July 1997, the OCMCS Board of Directors met to consider the business plan of OCMCS in light of the foregoing and conducted a detailed review of its competition and current market conditions, financial performance and condition, strategic relationships, access to capital and the needs of its stockholders, contracting physicians and patients served by its physicians. Following such review, the OCMCS Board of Directors determined to assess the opportunities available for a strategic affiliation or sale of OCMCS and, to that end, created a special committee (the "Special Committee"). The Special Committee consists of all OCMCS directors without conflicts of interest. In

addition, four of the OCMCS directors on the Special Committee also serve on the SJMC Board of Directors.

Pursuant to the MSO Purchase Agreement dated December 13, 1995, among OCMCS, SJMC and SJHO and other related agreements, SJHO had a "right of first offer" arrangement with OCMCS and SJMC with respect to certain corporate transactions (such as a sale or strategic affiliation). Pursuant to such agreements, prior to soliciting offers, OCMCS and SJMC were required to notify SJHO in writing of their intent to enter into one of the specified corporate transactions. As a result, on July 8, 1997, the Special Committee provided SJHO with the notice required under the MSO Agreement. Under the terms of the MSO Agreement, OCMCS was required to negotiate exclusively with SJHO in good faith as to such a transaction for a period of 60 days. On July 24, 1997, the Chief Executive Officer of OCMCS sent a follow-up letter to the Chief Executive Officer of SJHO noting the absence of any communication, proposal or inquiry from SJHO and affirming the readiness of OCMCS to enter into negotiations with SJHO.

On August 1, 1997, OCMCS received a written response from SJHO requesting that the exclusivity period be extended for an additional 90 days. The letter did not, however, contain any specific proposal. On August 4, 1997, OCMCS sent a letter to SJHO rejecting SJHO's request for an additional 90-day exclusivity period and requesting a specific and complete offer from SJHO. In addition, OCMCS identified to SJHO that a Special Committee of the Board of OCMCS had been formed for purposes of conducting negotiations with SJHO and other parties, should agreement not be reached with SJHO regarding a

transaction before expiration of the 60-day exclusivity period.

On August 11, 1997, SJHO requested due diligence information from OCMCS and SJMC and requested a meeting with representatives of OCMCS. SJHO failed to provide specific terms regarding a transaction in SJHO's letter. On August 13,1997, SJHO signed a confidentiality and non-disclosure agreement for the benefit of OCMCS and SJMC. In response to the request for information and in reliance upon the confidentiality agreement, OCMCS transmitted selected due diligence materials on August 14, 1997. On August 19, 1997, SJHO submitted a request to OCMCS for additional due diligence material. The 60-day exclusivity period expired on September 6, 1997, without OCMCS having received any proposal from SJHO or having reached any agreement with SJHO regarding a possible transaction.

The Special Committee, after interviewing five investment banking firms to assist it with its consideration of strategic alternatives, in early August 1997 retained Cowen & Company ("Cowen") to act as financial advisor to OCMCS in order to assist the Special Committee. At the direction of the Special Committee, Cowen initially contacted ten potential buyers and/or strategic partners for the OCMCS and SJMC business. Each of such potential buyers entered into a confidentiality agreement and received a confidential memorandum dated September 1997 prepared by Cowen concerning OCMCS and SJMC. On October 14, 1997, seven of the ten potential buyers submitted an initial indication of interest. After a review of all the indications of interest, the Special Committee invited four of the potential buyers to conduct a due diligence examination of OCMCS and SJMC. Throughout

October 1997, the four potential buyers continued to have discussions with management and completed their preliminary due diligence. In November 1997, OCMCS and SJMC management made presentations to the prospective buyers. The presentations were held on November 4, 5, 10 and 20, 1997. All four potential buyers submitted offers, and senior management of OCMCS, with its legal and financial advisors, and SJMC and its legal advisors, negotiated with the potential buyers to reach mutually acceptable terms for a transaction. During that time, senior management of OCMCS conducted numerous meetings and held discussions about potential transactions with representatives of OCMCS' institutional investors, members of the Special Committee, the legal advisors of OCMCS and SJMC, the financial advisor of OCMCS and members of the OCMCS and SJMC Boards. The Special Committee requested that revised bids be submitted by all four of the potential buyers by November 25, 1997. Of the four potential buyers that the Special Committee was still considering, three potential bidders (including SJHO as well as FPA) submitted revised bids, with FPA submitting the highest bid and being the only bidder who provided comments to a proposed acquisition agreement which had been circulated to the bidders. The Special Committee determined, however, that each of the bids needed further revision or clarification because of certain ambiguities in the bids with respect to the value of the consideration offered for the SJMC and OCMCS businesses. Cowen conducted informal discussions with all three remaining bidders to determine their level of interest in consummating an acquisition or merger. At the instruction of the Special Committee, Cowen communicated a December 8, 1997, deadline for "final" bids. On December 3, 1997, FPA responded to the request for final

bids with a "pre-emptive bid," requiring exclusivity on the part of OCMCS and SJMC for a period of thirty (30) days immediately following receipt of the FPA bid. A meeting of the Special Committee was held on December 5, 1997 to review and discuss the pre-emptive bid from FPA and the status of the other bidders. It was noted that the FPA bid was significantly greater in value than any of the prior bids, offered immediate liquidity if desired by the stockholders of OCMCS and the shareholders of SJMC, subject to certain time restrictions on sale of shares due to pooling and contractual requirements, and had the greatest likelihood of timely completion. In addition, the Special Committee noted that throughout the bid process, FPA had consistently recognized and been sensitive to issues regarding physician management and policies and procedures at OCMCS and SJMC.

The Special Committee determined that OCMCS stockholders and SJMC shareholders would receive greater value from a transaction with FPA due to its strategic fit, its complementary business plan, the proximity of FPA to OCMCS in terms of integration of operations and the market capitalization and liquidity of the FPA Common Stock. Additionally, the negotiated period of exclusivity (which expired on January 15, 1998) was determined not to materially impair the marketability and value of OCMCS and SJMC if a transaction with FPA did not occur. Accordingly, the two other potential buyers were notified of the pre-emptive bid.

On December 5, 1997, representatives of FPA and OCMCS and SJMC, together with their respective legal advisors and the financial advisors to FPA and OCMCS, conducted discussions concerning the ability to treat the transaction, or a portion thereof, as a pooling of interests

for accounting purposes. On December 8, 1997, the Special Committee met and reviewed the terms of the FPA bid. Following lengthy discussions, the Special Committee resolved to recommend to the full Boards of OCMCS and SJMC that their respective companies enter into exclusive negotiations with FPA.

On December 9, 1997, the OCMCS Board held a meeting at which the Special Committee presented its reasons for recommending entering into a period of exclusive negotiations with FPA. The OCMCS Board determined that it was in OCMCS's best interests to enter into exclusive negotiations with FPA. The OCMCS Board further determined that final approval for a transaction with FPA would be contingent upon satisfactory resolution of two conditions: (1) that SJIPA's and SJMG's physician compensation programs remain in place for an extended period beyond the closing and (2) that the ultimate transaction structure optimize accounting, tax and securities constraints for the benefit of the OCMCS stockholders and the SJMC shareholders, including but not limited to pooling of interests accounting treatment.

On December 11, 1997, the SJMC Board met to consider the FPA proposal. Representatives of the Special Committee delivered a presentation concerning the FPA bid and, following such presentation, the Board of SJMC voted to approve the entry by SJMC into an exclusive period of negotiation with FPA through January 15, 1998. In the last two weeks of December 1997 and early January 1998, OCMCS and SJMC representatives negotiated the Merger Agreement and conducted due diligence with respect to FPA.

On January 13, 1998, both the OCMCS Board and the SJMC Board met separately to consider approval of the Merger Agreement and the transactions contemplated thereby. The OCMCS Board and the SJMC Board concluded at their respective meetings that the transaction was fair and in the best interests of OCMCS stockholders and SJMC shareholders and approved the transaction. Negotiations were completed and the Merger Agreement was signed on January 21, 1998.

Recommendation of the SJMC Board of Directors and Reasons for the SJMC Merger

On January 13, 1998, the SJMC Board determined that the proposed SJMC Merger and the terms and conditions of the Merger Agreement and the transactions contemplated thereby are fair to, and in the best interests of, SJMC and its shareholders and resolved to recommend that the shareholders of SJMC vote FOR approval and adoption of the Merger Agreement. In reaching its decision to enter into and recommend the Merger Agreement, the SJMC Board consulted with management, as well as its accounting and legal advisors, and considered a number of factors, including without limitation and without assigning relative weights thereto, the following factors:

(i) the attractive opportunity to strengthen SJMC's competitive position and enhance its profile among physicians and Payors;

(ii) the increasing competitive pressures within the managed care sector of the health care industry, including the trend toward consolidation among Payors, providers and physician practice management companies;

(iii) the belief that there were strategic benefits which could be attained by combining FPA and SJMC's operations including, but not limited to, forming one of the largest physician practice management companies in California and in the nation and thereby providing the combined company with the opportunity to operate more effectively and profitably in an increasingly competitive environment as a result of the size, geographic scope and expertise of the combined company (especially in light of a shared operational approach between the two entities, with both companies having focused significantly on IPA management);

(iv) the belief that certain synergies could be attained by spreading the costs of infrastructure over a greater membership base (particularly in light of FPA's presence in the neighboring counties of San Diego and Los Angeles) and by combining operations and development activities, thereby reducing general and administrative expenses and contributing to the ability of the combined company to compete effectively in the future;

(v) the terms and conditions of the Merger Agreement and related agreements and the likelihood that the conditions to the SJMC Merger would be satisfied, as well as the prospects of OCMCS as an independent entity and as an affiliated entity with FPA;

(vi) the willingness of management to support the SJMC Merger;

(vii) the liquidity desire of the SJMC shareholders and the trading volume of FPA Common Stock and its effect on such liquidity, as well as the general financial condition and results of operations of FPA; and

(viii) the willingness of FPA to commit to maintaining existing physician compensation and governance programs.

In addition to the foregoing factors, the SJMC Board also considered several negative factors or outcomes that could result from the SJMC Merger, including, but not limited to:

(i) the risk that the SJMC Merger would not be consummated;

(ii) the ability of FPA to integrate and continue successfully SJMC's operations after the SJMC Merger;

(iii) the ability of FPA to sustain its growth strategy; and

(iv) the amount of FPA's indebtedness in relation to its total capitalization.

The SJMC Board reviewed all of these factors, without focusing on any one individual factor, and concluded that on balance, the risks relating to the SJMC Merger are outweighed by the potential benefits to be achieved through the SJMC Merger.

The foregoing discussion of the information and factors considered is not intended to be exhaustive, but it does include the material factors considered by the SJMC Board in its evaluation of the SJMC Merger. The SJMC Board determined that the SJMC Merger was fair to and in the best interest of the SJMC shareholders and that SJMC should proceed with the SJMC Merger.

ACCORDINGLY, THE SJMC BOARD OF DIRECTORS RECOMMENDS THAT THE SHAREHOLDERS OF SJMC VOTE "FOR"

APPROVAL OF THE PROPOSAL TO ADOPT THE MERGER AGREEMENT.

Recommendation of the OCMCS Board of Directors and Reasons for the OCMCS Merger Agreement

On January 13, 1998, the OCMCS Board determined that the proposed Merger and the terms and conditions of the Merger Agreement and the transactions contemplated thereby are fair to, and in the best interests of, OCMCS and its stockholders and resolved to recommend that the stockholders of OCMCS vote FOR approval and adoption of the Merger Agreement. In reaching its decision to enter into and recommend the Merger Agreement, the OCMCS Board consulted with management, as well as its financial, accounting and legal advisors, and considered a number of factors, including, without limitation and without assigning relative weights thereto, the following factors:

(i) the attractive opportunity to strengthen OCMCS's competitive position and enhance its profile among physicians and Payors;

(ii) the increasing competitive pressures within the managed care sector of the health care industry, including the trend toward consolidation among Payors, providers and physician practice management companies;

(iii) the belief that there were strategic benefits which could be attained by combining FPA and OCMCS' operations including, but not limited to, forming one of the largest physician practice management companies in California and in the nation and thereby providing the combined company with the opportunity to operate more effectively and profitably in an increasingly competitive

environment as a result of the size, geographic scope and expertise of the combined company (especially in light of a shared operational approach between the two entities, with both companies having focused significantly on IPA management);

(iv) the belief that certain synergies could be attained by spreading the costs of infrastructure over a greater membership base (particularly in light of FPA's presence in the neighboring counties of San Diego and Los Angeles) and by combining operations and development activities, thereby reducing general and administrative expenses and contributing to the ability of the combined company to compete effectively in the future;

(v) the advice of Cowen rendered to the OCMCS Board and the delivery of a written opinion letter dated February 5, 1998 to the effect that, as of the date of such opinion and based upon and subject to certain matters stated therein, the Merger Consideration in the aggregate is fair from a financial point of view (see " – Opinion of OCMCS' Financial Advisor");

(vi) the terms and conditions of the Merger Agreement and the likelihood that the conditions to the OCMCS Merger would be satisfied, as well as the prospects of OCMCS as an independent entity and as an affiliated entity with FPA;

(vii) the willingness of management to support the OCMCS Merger;

(viii) the liquidity desire of the OCMCS stockholders and the trading volume of FPA Common Stock and its effect on such liquidity, as well as the general financial condition and results of operations of FPA; and

(ix) the willingness of FPA to commit to maintaining existing physician compensation and governance programs.

If the OCMCS Merger is consummated, the Board of Directors of OCMCS believes that OCMCS will have access to additional capital, management resources and clinical information systems which could enhance the competitiveness and profitability of OCMCS. Finally, the Board believes that the OCMCS Merger will provide OCMCS stockholders, through their ownership of FPA Common Stock, with enhanced liquidity due to the market capitalization of FPA, as well as the opportunity to realize additional appreciation in the value of their investment to the extent the foregoing potential benefits of the OCMCS Merger are realized.

In addition to the foregoing factors, the OCMCS Board also considered several negative factors or outcomes that could result from the OCMCS Merger, including, but not limited to:

(i) the risk that the OCMCS Merger would not be consummated;

(ii) the ability of FPA to integrate and continue successfully OCMCS's operations after the OCMCS Merger;

(iii) the ability of FPA to sustain its growth strategy; and

(iv) the amount of FPA's indebtedness in relation to its total capitalization.

The OCMCS Board reviewed all of these factors, without focusing on any one individual factor, and concluded that on

balance, the risks relating to the combined company were outweighed by the potential benefits to be achieved through the OCMCS Merger.

The foregoing discussion of the information and factors considered by the OCMCS Board is not intended to be exhaustive, but it does include the material factors considered by the OCMCS Board in its evaluation of the OCMCS Merger. The OCMCS Board determined that the OCMCS Merger was fair to and in the best interest of the OCMCS stockholders and that OCMCS should proceed with the OCMCS Merger.

ACCORDINGLY, THE OCMCS BOARD RECOMMENDS THAT THE STOCKHOLDERS OF OCMCS VOTE "FOR" APPROVAL OF THE PROPOSAL TO ADOPT THE MERGER AGREEMENT.

Opinion of OCMCS' Financial Advisor

Pursuant to an engagement letter dated August 6, 1997 (the "Cowen Engagement Letter"), the Board of Directors of OCMCS engaged Cowen to serve as its financial advisor. Cowen was selected by OCMCS as its financial advisor, and to render an opinion to OCMCS, because Cowen is a nationally recognized investment banking firm and because certain principals of Cowen have substantial experience in transactions similar to the Combined Merger and are familiar with OCMCS and its businesses. As part of its investment banking business, Cowen is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions and valuations for corporate and other purposes. In addition, a limited partner of Cowen owns less than 0.5% of the outstanding shares of OCMCS Series B Preferred Stock.

The full text of the written opinion of Cowen, dated February 5, 1998, is attached hereto as Appendix B and is incorporated by reference. Holders of OCMCS Voting Securities are urged to read the opinion in its entirety for the assumptions made, procedures followed, other matters considered and limits of the review by Cowen. This summary of the written opinion of Cowen is qualified in its entirety by reference to the full text of such opinion. Cowen's analyses and opinion were prepared for and addressed to OCMCS and are directed only to the fairness, from a financial point of view, of the aggregate consideration to be paid in the Combined Merger and do not constitute an opinion as to the merits of the Combined Merger or a recommendation to any holders of OCMCS Voting Securities as to how to vote on the OCMCS Merger.

In arriving at its opinion, Cowen (a) reviewed the combined financial statements of OCMCS and SJMC for the fiscal year ended December 31, 1996, and the seven months ended July 31, 1997 and certain other relevant financial and operating data of OCMCS and SJMC provided to Cowen by management of OCMCS; (b) reviewed FPA's publicly available combined consolidated financial statements for the fiscal year ended December 31, 1996 and the nine month periods ended September 30, 1996 and September 30, 1997, certain publicly available filings with the Commission and certain other relevant financial and operating data of FPA provided to Cowen by management of FPA; (c) reviewed the Merger Agreement; (d) held meetings and discussions with management and senior personnel of OCMCS to discuss the business, operations, historical financial results and future prospects of OCMCS and SJMC; (e) reviewed financial projections furnished by

the management of OCMCS including, among other things, the capital structure, revenue, net income, cash flow, capital requirements and other data of OCMCS and SJMC; (f) reviewed the combined valuation of OCMCS and SJMC in comparison to certain publicly traded companies; (g) compared the Combined Merger with the acquisition of other companies through certain other transactions; (h) analyzed the potential pro forma financial effects of the Combined Merger; (i) held a meeting with senior management of FPA to discuss FPA's historical financial results and financial projections furnished by the management of FPA, as well as the future prospects of FPA; and (j) conducted such other studies, analyses, inquiries and investigations as Cowen deemed appropriate. At the request of OCMCS, Cowen also solicited third party indications of interest in acquiring OCMCS and SJMC.

Upon the advice of OCMCS' management and with the consent of OCMCS, Cowen relied upon the accuracy and completeness of the financial and other information that was available to it from public sources, that was provided to it by OCMCS or FPA or that was otherwise reviewed by it. Cowen did not assume any responsibility for independent verification of such information, including financial information. In addition, Cowen assumed the attainability of the financial results in the financial forecasts, projections and estimates of operating efficiencies and potential synergies provided by OCMCS' and FPA's respective managements as to the expected future financial performance of their respective companies, and management of OCMCS confirmed that such forecasts, projections and estimates provided a reasonable basis for Cowen's opinion. Because such forecasts, projections and estimates are inherently subject to uncertainty, none of

OCMCS, FPA, Cowen or any other person assumes responsibility for their accuracy. Further, Cowen did not make an independent evaluation or appraisal of any of the properties or assets of the Company, SJMC or FPA, nor was Cowen furnished with any such evaluation or appraisal.

For the purposes of rendering its opinion, Cowen assumed that the representations and warranties of each party contained in the Merger Agreement are true and correct, that each party will perform all of the covenants and agreements required to be performed by it under the Merger Agreement and that all conditions to the consummation of the Combined Merger will be satisfied without waiver thereof. Cowen also assumed that all governmental, regulatory and other consents and approvals contemplated by the Merger Agreement will be obtained and that in the course of obtaining those consents no restrictions will be imposed or waivers made that would have an adverse effect on the contemplated benefits of the Combined Merger. Cowen further assumed that there have been no material changes in the assets, financial condition, results of operations, business or prospects of OCMCS, SJMC or FPA since the date of the last financial statements received by Cowen. Cowen did not express any opinion as to the likely trading range for FPA Common Stock following consummation of the Combined Merger or otherwise. Cowen's opinion was necessarily based on general economic, market, financial and other conditions as they existed on, and could be evaluated as of, February 5, 1998, as well as on the information made available to it as of February 5, 1998. It should be understood that, although developments subsequent to February 5, 1998

may affect its opinion, Cowen does not have any obligation to update, revise or reaffirm its opinion.

For purposes of this opinion, Cowen analyzed as a whole the consideration to be paid by FPA and to be received by all holders of OCMCS Voting Securities, OCMCS Options and SJMC Common Stock. Cowen is not expressing any opinion as to the allocation of such consideration between OCMCS and SJMC or amongst such shares of OCMCS Voting Securities and OCMCS Options.

* * *

Certain Federal Income Tax Consequences

* * *

Consequences to SJMC Shareholders and OCMCS Stockholders. Under the reorganization provisions of Section 368(a) of the Code, if applicable to the Combined Merger, (i) no gain or loss will be recognized by holders of SJMC Common Stock or OCMCS Stock with respect thereto as a result of the surrender of their shares of SJMC Common Stock and OCMCS Stock in exchange for shares of FPA Common Stock pursuant to the Combined Merger (except as discussed below with respect to cash received in lieu of fractional shares), and (ii) the aggregate tax basis of the shares of FPA Common Stock received in the Combined Merger (including any fractional shares of FPA Common Stock deemed received) will be the same as the aggregate tax basis of the shares of SJMC Common Stock and OCMCS Stock surrendered in exchange therefor in the Combined Merger. The holding period of the shares of FPA Common Stock received (including the holding period of fractional shares of FPA Common Stock deemed received) will include the holding period of shares of SJMC

Common Stock and OCMCS Stock surrendered in exchange therefor.

* * *

Resale of FPA Common Stock by Affiliates

The FPA Common Stock to be issued to shareholders of SJMC and stockholders of OCMCS in connection with the Combined Merger has been registered under the Securities Act pursuant to the Registration Statement of which this Proxy Statement/Prospectus forms a part. The FPA Common Stock received by the shareholders of SJMC and stockholders of OCMCS upon consummation of the Combined Merger will be freely transferable under the Securities Act, except (i) for shares of FPA Common Stock to be received in exchange for OCMCS Stock and OCMCS Options, which shall be restricted from sale, transfer or other dispositions for a period of 90 days commencing as of the Effective Time; provided that holders of OCMCS Options may sell, transfer or otherwise dispose of that member [sic] of shares of FPA Common Stock to pay the exercise price and the minimum federal and state withholding taxes, if any due and payable upon such exercise; and (ii) for shares issued to any person who may be deemed an "Affiliate" (as defined below) of SJMC, OCMCS or FPA within the meaning of Rule 145 promulgated under the Securities Act ("Rule 145"). Affiliates are generally defined as persons who control, are controlled by, or are under common control with SJMC, OCMCS or FPA at the time of the SJMC and OCMCS Special Meetings (generally, directors, certain executive officers and major stockholders). Affiliates of SJMC, OCMCS or FPA may not sell their shares of FPA Common Stock acquired in connection with the Combined Merger, except pursuant to an effective registration statement under the Securities Act covering

such shares or in compliance with Rule 145 or another applicable exemption from the registration requirements of the Securities Act. In general, under Rule 145, for one year following the Effective Time, an Affiliate (together with certain related persons) would be entitled to sell shares of FPA Common Stock acquired in connection with the Combined Merger only through unsolicited "broker transactions" or in transactions directly with a "market maker," as such terms are defined in Rule 144 promulgated under the Securities Act ("Rule 144"). Additionally, the number of shares to be sold by an Affiliate (together with certain related persons and certain persons acting in concert) during such one-year period within any three-month period for purposes of Rule 145 may not exceed the greater of 1% of the outstanding shares of FPA Common Stock or the average weekly trading volume of such stock during the four calendar weeks preceding such sale. Rule 145 would remain available to Affiliates only if FPA remained current with its information filings with the Commission under the Exchange Act. One year after the Effective Time, an Affiliate would be able to sell such FPA Common Stock without such manner of sale or volume limitations, provided that FPA was current with its Exchange Act information filings and such Affiliate was not then an Affiliate of FPA. Two years after the Effective Time, an Affiliate would be able to sell such shares of FPA Common Stock without any restrictions, provided that such Affiliate has not been an Affiliate of FPA for at least three months prior thereto. In addition, under rules relating to "pooling of interests" accounting, shares of FPA Common Stock issued to affiliates of SJMC may not be resold by them until combined results of operations of FPA

and SJMC covering at least thirty days of operations are published.

* * *

THE MERGER AGREEMENT

The following is a summary of the material provisions of the Merger Agreement not summarized elsewhere in this Proxy Statement/Prospectus. A copy of the Merger Agreement is attached as Appendix A to this Proxy Statement/Prospectus and is incorporated herein by reference. The following summary does not purport to be complete and is qualified in its entirety by reference to the Merger Agreement.

The Combined Merger

The Merger Agreement provides that, subject to the approval and adoption of the Merger Agreement by the shareholders of SJMC and stockholders of OCMCS and the satisfaction or waiver of other conditions to the Combined Merger, SJMC will be merged with and into FPA California and immediately thereafter OCMCS will be merged with and into FPA California in accordance with the Delaware Act and the California Code. As a result of the Combined Merger, the separate existence of SJMC and OCMCS will cease.

At the Effective Time:

(i) Each issued and outstanding share of SJMC Common Stock, OCMCS Stock and each OCMCS Option (if exercised), except as provided for below, will be exchanged for the right to receive a number of shares of FPA Common Stock based on the applicable Exchange Ratios.

For a discussion of the Exchange Ratios, see "THE COMBINED MERGER – Merger Consideration."

(ii) The outstanding shares of OCMCS Series A Preferred Stock will be cancelled without consideration in connection with the OCMCS Merger.

(iii) Each share of OCMCS Common Stock and OCMCS Preferred Stock held in OCMCS' treasury will be cancelled and extinguished and will cease to exist, and no consideration will be delivered with respect thereto.

(iv) If applicable, each outstanding share of SJMC Common Stock and OCMCS Stock, the holder of which (a) has not voted in favor of the Combined Merger, (b) has perfected such holder's dissenters' rights to appraisal in accordance with the pertinent provisions of the Delaware Act or the California Code, whichever is applicable, and (c) has not effectively withdrawn or lost such rights to appraisal, will not be converted into a right to receive shares of FPA Common Stock, but such holder shall be entitled only to such rights as are granted under the applicable provisions of the Delaware Act or the California Code, whichever is applicable. See "THE COMBINED MERGER – Rights of Dissenting Shareholders and Stockholders."

At the Effective Time, holders of SJMC Common Stock and OCMCS Stock will cease to have any rights as holders of such shares, other than, if applicable, dissenters' rights to appraisal, but will have the right to receive shares of FPA Common Stock and cash in lieu of any fractional shares of FPA Common Stock.

* * *

Certain Representations and Warranties

The Merger Agreement contains various representations and warranties of each of FPA, FPA California, SJMC and OCMCS (which are subject, in certain cases, to specified exceptions, and which shall continue until the first anniversary of the Closing Date, except for representations related to taxes, which shall survive until expiration of the applicable statute of limitations, and claims related to fraud, which shall survive until expiration of the applicable statute of limitations) relating to, among other things, the following: (i) organization and qualification to do business; (ii) capitalization; (iii) subsidiaries; (iv) the authorization, execution, delivery and enforceability of the Merger Agreement and the transactions contemplated thereunder; (v) the absence of any governmental or regulatory consent or approval required to enter into the Merger Agreement and to consummate the transactions contemplated thereby, except as so disclosed; (vi) the absence of any conflict, breach or default of any corporate charter documents or applicable law in connection with entering into the Merger Agreement; (vii) the accuracy of the financial information contained therein; (viii) the absence of certain changes or events; (ix) the absence of undisclosed liabilities; (x) the absence of pending or threatened legal proceedings; (xi) the accuracy of the information each party has supplied with respect to the filings required with the Commission in order to consummate the Combined Merger and the transactions contemplated by the Merger Agreement; (xii) certain tax matters including the tax-free status of the transaction under sections 368(a)(1)(A) and 368(a)(2)(D) of the Code; (xiii) matters concerning employee benefit plans and ERISA; (xiv) title to assets; (xv) permits of each of SJMC and OCMCS; (xvi)

agreements; (xvii) insurance; (xviii) compliance with laws; and (xix) accounting matters. Such representations and warranties are limited to the extent that any event or occurrence that has or, if it occurred reasonably would be expected to have, an adverse effect in each case in excess of Five Hundred Thousand Dollars ($500,000) for SJMC and OCMCS and Fifty Million Dollars ($50,000,000) for FPA and its subsidiaries taken as a whole, on the business, condition (financial or otherwise), results of operations, prospects, assets (including intangible assets), properties or liabilities (including contingent liabilities) of SJMC, OCMCS and FPA, respectively.

Conduct of Business Pending the Combined Merger

* * *

At all times from and after the date of the Merger Agreement until the Closing Date, each of FPA and FPA California covenants and agrees that (except as expressly contemplated or permitted by the Merger Agreement, or to the extent that SJMC and OCMCS shall otherwise consent in writing): (i) it shall not make any material changes to its business or structure which would reasonably be expected to have an adverse effect on the consideration to be received by the SJMC shareholders and the OCMCS stockholders; (ii) it shall use all reasonable efforts to take all such actions as are necessary to effectuate the transactions contemplated hereby and to fulfill and cause to be fulfilled the conditions to closing under the Merger Agreement; and (iii) it shall not take any action to cause the transactions contemplated by the Merger Agreement not to be treated as a tax-free reorganization within the

meaning of Section 368(a)(1)(A) and Section 368(a)(2)(D) of the Code.

Each of FPA, FPA California, SJMC and OCMCS has further agreed prior to the Effective Time to confer on a regular and frequent basis with the other with respect to its business and operations and other matters relevant to the Combined Merger and shall promptly advise the other of any change or event, including any complaint, investigation or hearing by any governmental or regulatory authority on the constitution or threat of litigation, having or which can be reasonably foreseen to have, a material adverse effect on OCMCS, SJMC, FPA or FPA California, as the case may be, or on the ability of any of the parties to consummate the transactions contemplated by the Merger Agreement.

Certain Additional Agreements

Pursuant to the Merger Agreement, FPA, FPA California, SJMC and OCMCS have made the following additional agreements.

* * *

Employee Benefit Plans. In the Merger Agreement, FPA agreed that FPA shall, or shall cause FPA California to, provide employee benefits for the benefit of SJMC and OCMCS employees who become FPA or FPA California employees, which, in the aggregate, are substantially similar to those provided under the FPA Employee Benefit Plans applicable to similarly situated employees of FPA or its affiliates. Other than with respect to the FPA Employee Stock Purchase Plan, FPA shall give each SJMC and OCMCS employee full credit for the service credited to such employee under the respective SJMC or OCMCS

Employee Benefit Plans and FPA shall waive any applicable waiting periods under the FPA Employee Benefit Plans, subject to applicable law.

FPA agreed to honor, and agreed to cause the Surviving Corporation to honor, in accordance with their terms, all existing employment, severance, consulting and salary continuation agreements between SJMC and OCMCS and any current or former officer, director, employee or consultant to SJMC or OCMCS.

Directors' and Officers' Indemnification and Insurance. FPA agreed to indemnify all past or present directors, officers, employees, agents and stockholders who are officers or directors of SJMC or OCMCS against any liability or losses (including attorney's fees for counsel who are reasonably acceptable to FPA) any of them may incur because of any claim brought against them prior to or within five years from the Effective Time as officers, directors, employees, agents or stockholders of SJMC or OCMCS, and in connection therewith, agreed to advance attorney's fees to them to defend any such claim; provided that any such indemnification by FPA and FPA California shall be in excess of any available insurance coverage; and provided, further, that FPA shall not be obligated pursuant to the Merger Agreement to pay the fees and disbursements of more than one counsel for all Indemnified Parties in any single action, except to the extent that, in the opinion of counsel for the Indemnified Parties, two or more of such Indemnified Parties have conflicting interests in the outcome of such action. FPA may obtain directors' and officers' liability insurance to cover these obligations.

Malpractice Protection. As of the Effective Time, FPA California shall procure and maintain professional liability insurance for the benefit of the SJMC shareholders with commercially reasonably [sic] limits of coverage, but no less than $1,000,000 per claim and $3,000,000 in the aggregate covering professional services rendered by such shareholders after the Effective Time. FPA California shall also procure and maintain business and medical malpractice coverage similar in type and amount to that maintained by SJMC immediately prior to the Closing to protect the SJMC shareholders after the Closing.

Provider Relations and Compensation Programs. As of the Effective Time, FPA California shall establish an Orange County Quality Improvement Committee substantially as currently in existence for its California operations. The initial membership of the Committee shall be selected by FPA California and the Board of Directors of SJMC prior to the Effective Time. FPA California shall also establish two Leadership Councils (the St. Joseph IPA Leadership Council and the St. Joseph Medical Group Leadership Council) with designated members. The Leadership Councils shall be advisory councils providing, respectively, advice on the operations of the IPA and medical group operations. FPA California will maintain for two years after the Effective Time the SJMC compensation program for the SJMC IPA physicians and the SJMG Medical Group physicians as in effect as of the date of the Merger Agreement, unless there is an adverse change in the California healthcare market place in which event FPA California may reassess and modify the IPA and medical group compensation programs to meet such changed conditions. After the Effective Time, FPA California may

re-negotiate contracts for services provided on a fee-for-service basis.

* * *

Fulfillment of Conditions. Subject to the terms and conditions of the Merger Agreement, each of FPA, FPA California, SJMC and OCMCS agreed to take or cause to be taken all steps necessary or desirable and proceed diligently and in good faith to satisfy each condition to the other's obligations contained in the Merger Agreement and to consummate and make effective the transactions contemplated by the Merger Agreement, and further agreed that neither FPA, FPA California, SJMC nor OCMCS will take or fail to take any action that could be reasonably expected to result in the nonfulfillment of any such condition.

No Solicitations. Prior to the Closing Date, each of SJMC and OCMCS agreed that (a) it shall not, and it shall use its best efforts to cause its respective Representatives not to, initiate, solicit or encourage, directly or indirectly, any inquiries or the making or implementation of any proposal or offer (including, without limitation, any proposal or offer to its stockholders) with respect to a merger, consolidation or other business combination including SJMC or OCMCS or any acquisition or similar transaction (including, without limitation, a tender or exchange offer) involving the purchase of (i) all or any portion of the assets of SJMC or OCMCS, or (ii) any of the outstanding shares of SJMC Common Stock or OCMCS Stock (any such proposal or offer being hereinafter referred to as an "Alternative Proposal"), or engage in any negotiations concerning, or provide any confidential information or data to, or have any discussions with, any

person or group relating to an Alternative Proposal (excluding the transactions contemplated by the Merger Agreement), or otherwise facilitate any effort or attempt to make or implement an Alternative Proposal and (b) it will notify FPA and FPA California immediately if any such inquiries, proposals or offers are received by, any such information is requested from, or any such negotiations or discussions are sought to be initiated or continued with, it or any such person or group; and (c) it will, prior to accepting an Alternative Proposal, (i) receive a determination from an independent financial advisor that such Alternative Proposal is more favorable to the OCMCS Stockholders or the SJMC Shareholders than the transactions contemplated by the Merger Agreement, (ii) determine in the exercise of its fiduciary obligations that such Alternative Proposal is more favorable to the OCMCS Stockholders or SJMC Shareholders than the transactions contemplated by the Merger Agreement and give FPA and FPA California at least three days to offer a counterproposal prior to executing a definitive agreement.

FPA, SJMC and OCMCS Affiliates. Within five business days after the date of the Merger Agreement (i) SJMC and OCMCS will deliver a letter to FPA and FPA California identifying all persons who may be deemed affiliates of SJMC and OCMCS under Rule 145, including, without limitation, all directors and executive officers of SJMC and OCMCS and (ii) SJMC and OCMCS shall advise the persons identified in such letter of the resale restrictions imposed by applicable securities laws and (iii) SJMC shall advise the affiliates of SJMC of Accounting Series Release Number 135 ("ASR 135"). Each of FPA, FPA California and SJMC shall use its reasonable best efforts to obtain as soon as practicable after the date of the

Merger Agreement from affiliates of FPA, FPA California and SJMC, as the case may be, an agreement that such persons will comply with the provision of ASR 135.

Resale Restrictions. The shares of FPA Common Stock to be received in exchange for the OCMCS Common Stock, the OCMCS Preferred Stock and the OCMCS Options shall be restricted from sale, transfer or other disposition for a period of 90 days commencing as of the Effective Time; provided, however, that the holders of OCMCS Options may sell, transfer or otherwise dispose of that number of shares of FPA Common Stock received upon exercise of such OCMCS Options whose value equals the sum of the exercise price payable with respect to such OCMCS Option and the minimum statutory federal and state withholding taxes immediately due and payable upon such exercise. All shares of FPA Common Stock subject to such transfer restriction shall contain a legend to such effect which shall be removed effective upon the 91st day after the Effective Time.

Conditions to Consummation of the Combined Merger

* * *

The obligation of SJMC and OCMCS to effect the Combined Merger is further subject to the fulfillment, at or prior to the Closing, of each of the following conditions (all or any of which may be waived in whole or in part by SJMC or OCMCS in its sole discretion): (i) FPA and FPA California shall have performed in all Material respects each Material agreement, covenant and obligation required by the Merger Agreement to be performed or complied with by them on or prior to the Closing Date and

the representations and warranties of FPA and FPA California in the Merger Agreement shall be true and correct in all Material respects (except for such representations and warranties that are qualified by their terms by a referral to materiality, which representations and warranties as so qualified shall be true in all respects) on and as of the date made and on and as of the Closing Date as though made on and as of the Closing and each of FPA and FPA California shall have delivered to SJMC and OCMCS certificates, dated the Closing Date and executed on behalf of FPA and FPA California by its Chairman of the Board, President or any Executive or Senior Vice President to such effect; (ii) SJMC and OCMCS shall have received all certificates, instruments, agreements, and other documents to be delivered by FPA or FPA California required by the Merger Agreement on or before the Closing Date; and (iii) SJMC and OCMCS shall have received copies of resolutions of each of FPA and FPA California certified by a Secretary, Assistant Secretary or other appropriate officer of such company, authorizing the execution, delivery and performance of the Merger Agreement and the Merger Agreement and any documents related thereto.

To the extent that FPA, SJMC or OCMCS waives compliance with any material provisions of or conditions to the consummation of the Combined Merger, including the condition that the SJMC Merger be treated as a "pooling of interests" for accounting and financial reporting purposes and that the Combined Merger qualify as a tax-free reorganization, FPA, SJMC and OCMCS will amend this Proxy Statement/Prospectus and SJMC and OCMCS will resolicit shareholder and stockholder votes, to the extent required by applicable law.

* * *

Indemnification

* * *

The representations and warranties of OCMCS and SJMC, on the one hand, and FPA and FPA California, on the other hand, contained in the Merger Agreement or in any document or instrument delivered pursuant thereto shall survive the Closing Date and shall continue in full force and effect until the first anniversary of the Closing Date, except with respect to payment of taxes and fraud, which shall survive until the expiration of the applicable statute of limitations thereto.

* * *

EXPERTS

The consolidated financial statements of FPA incorporated in this Proxy Statement/Prospectus by reference from FPA's Annual Report on Form 10-K, as amended by Form 10-K/A, for the year ended December 31, 1996 have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report which is incorporated by reference herein, and have been incorporated by reference in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

* * *

The Consolidated Financial Statements of FPA incorporated in this Proxy Statement/Prospectus by reference from FPA's Current Report on Form 8-K dated July 31, 1997 as amended by Form 8-K/A have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report which is incorporated herein by reference, and have been incorporated herein by reference in reliance

upon the report of such firm given upon their authority as experts in accounting and auditing.

The Supplemental Consolidated Financial Statements of FPA incorporated in this Proxy Statement/Prospectus by reference from FPA's Current Report on Form 8-K dated December 9, 1997, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report which is incorporated herein by reference, and have been incorporated herein by reference in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The Consolidated Financial Statements of AHI Healthcare Systems, Inc. as of December 31, 1996 and the year then ended incorporated in this Proxy Statement/Prospectus by reference from FPA's Current Report on Form 8-K dated March 17, 1997, as amended by Form 8-K/A, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their report which is incorporated herein by reference, and have been incorporated herein by reference in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

The Consolidated Financial Statements of AHI Healthcare Systems, Inc. as of December 31, 1995 and for each of the two years in the period ended December 31, 1995, included in the consolidated financial statements of FPA for such periods, which statements appear in the Current Reports on Form 8-K filed on December 10, 1997, July 31, 1997 and May 30, 1997, and incorporated herein by reference, have been audited by Ernst & Young LLP, independent auditors, as stated in their reports therein and incorporated herein by reference, and have been

incorporated herein by reference in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

* * *

The combined financial statements of Foundation Health Medical Services (a wholly-owned subsidiary of Foundation Health Corporation) and Affiliates as of June 30, 1995 and 1996 and for each of the three years in the period ended June 30, 1996, incorporated in this Proxy Statement/Prospectus by reference from FPA's Registration Statement on Form S-4, filed on February 13, 1997 have been audited by Deloitte & Touche LLP (except for the December 31, 1993 financial statements of Thomas-Davis Medical Centers, P.C.) as stated in their report which is incorporated herein by reference (such report expresses an unqualified opinion and includes an explanatory paragraph referring to significant related party transactions), and have been incorporated herein by reference in reliance upon the report of such firm given upon their authority as experts in accounting and auditing. The financial statements of Thomas-Davis Medical Centers, P.C. for the year ended December 31, 1993 have been audited by Stevenson, Jones, Imig, Holmaas & Kleinhans, P.C., as stated in their report incorporated herein by reference.

* * *

APPENDIX A

AGREEMENT AND PLAN OF MERGER
dated as of January 21, 1998
by and among

FPA MEDICAL MANAGEMENT, INC.,
FPA MEDICAL MANAGEMENT OF CALIFORNIA, INC.,
ORANGE COAST MANAGED CARE SERVICES, INC.
and
ST. JOSEPH MEDICAL CORPORATION

* * *

This AGREEMENT AND PLAN OF MERGER dated as of January 21, 1998 (the "Signing Date") is made and entered into by and among FPA Medical Management, Inc., a Delaware corporation ("FPA"), FPA Medical Management of California, Inc., a California corporation and wholly-owned subsidiary of FPA ("Sub"), Orange Coast Managed Care Services, Inc., a Delaware corporation ("OCMCS"), and St. Joseph Medical Corporation, a California professional corporation ("SJMC").

WHEREAS, FPA, Sub, OCMCS and SJMC have each determined that it is advisable and in their best interests to consummate, and have approved, the business combination transaction provided for herein in which OCMCS and SJMC would merge with and into Sub (the "Merger"); and

WHEREAS, FPA, Sub, OCMCS and SJMC desire to make certain representations, warranties and agreements in connection with the Merger and also to prescribe various conditions to the Merger;

NOW, THEREFORE, in consideration of the mutual covenants and agreements set forth in this Agreement, and for other good and valuable consideration, the receipt

and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

* * *

ARTICLE V
REPRESENTATIONS AND WARRANTIES OF FPA AND SUB

Each of FPA and Sub represents and warrants to OCMCS and SJMC that the statements contained in this Article V are true, correct and complete as of the Signing Date and will be true, correct and complete as of the Closing Date (as though made then and as though the Closing Date were substituted for the Signing Date throughout this Article), except as set forth in the Exhibits to this Agreement.

For purposes of the representations and warranties provided in this Article V, the term "Knowledge of FPA and Sub" shall be defined as the actual knowledge of any person who is at the signing or Closing, as applicable, an officer or director of FPA or Sub, as the case may be. For purposes of this Article V, the phrase "Material Adverse Effect" or the word "Material" shall mean any event or occurrence that has or, if it occurred reasonably would be expected to have, ran [sic] adverse effect in each case in excess of Fifty Million Dollars ($50,000,000) on the business, condition (financial or otherwise), results of operations, prospects, assets (including intangible assets), properties or liabilities (including contingent liabilities) of FPA and its Subsidiaries, taken as a whole.

* * *

5.7 *SEC Reports and FPA Financial Statements.* FPA has made available to OCMCS and SJMC a true and complete copy of each form, report, schedule, registration

statement, definitive proxy statement and other document (together with all amendments thereof and supplements thereto) filed by FPA with the SEC since January 1, 1997 (as such documents have since the time of their filing been amended or supplemented, the "FPA SEC Reports"), which are all the documents (other than preliminary material) that FPA was required to file with the SEC since such date. As of their respective dates, the FPA SEC Reports (i) complied as to form in all Material respects with the requirements of the Securities Act or the Exchange Act, as the case may be, and (ii) did not contain any untrue statement of a Material fact or omit to state a Material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they were made, not misleading. The audited consolidated financial statements and unaudited interim consolidated financial statements (including, in each case, the notes, if any, thereto) included in the FPA SEC Reports (the "FPA Financial Statements") complied as to form in all Material respects with the published rules and regulations of the SEC with respect thereto, were prepared in accordance with GAAP applied on a consistent basis during the periods involved (except as may be indicated therein or in the notes thereto and except with respect to unaudited statements as permitted by Form 10-Q of the SEC) and fairly present (subject, in the case of the unaudited interim financial statements, to normal, recurring year-end audit adjustments which are not expected to be, individually or in the aggregate, Materially Adverse to FPA and its Subsidiaries taken as a whole) the consolidated financial position of FPA and its consolidated Subsidiaries as at the respective dates thereof and the consolidated results of their operations and cash flows for the respective periods then ended.

5.8 *Absence of Changes.* Since September 30, 1997, there has not been any Material Adverse Change to FPA and its Subsidiaries taken as a whole.

5.9 *Absence of Undisclosed Liabilities.* FPA and Sub do not have any debts, liabilities or obligations of any nature (whether absolute, accrued, unliquidated, contingent or otherwise, whether known or unknown, and whether due or to become due) which are likely to have a Material Adverse Effect on FPA and its Subsidiaries taken as a whole, other than those which (a) are set forth in the FPA Financial Statements, (b) have been specifically disclosed elsewhere herein, (c) are exempt from disclosure pursuant to this Agreement, or (d) have been incurred since the date of the most recent FPA Financial Statements in the ordinary course of business in amounts and on terms consistent, individually and in the aggregate, with FPA's past practice.

* * *

5.17 *Registration Statement and Proxy Statement.* None of the information to be supplied by FPA for inclusion in the Registration Statement or the Proxy Statement/Prospectus will, in the case of the Proxy Statement/Prospectus or any amendments thereof or supplements thereto, at the time of the mailing of the Proxy Statement/Prospectus and any amendments or supplements thereto, and at the time of the meeting of the stockholders of OCMCS and the shareholders of SJMC, contain any untrue statement of a Material fact or omit to state a Material fact required to be stated therein or necessary in order to make the statements therein, in light of the circumstances under which they are made, not misleading, or, in the case of the Registration Statement,

as amended or supplemented, at the time it becomes effective and at the time of such meeting, contain any untrue statement of a Material fact or omit to state any Material fact required to be stated therein or necessary in order to make the statements therein not misleading. The Proxy Statement/Prospectus, as of its effective time, will comply as to form in all Material respects with all applicable laws, including the provisions of the Securities Act and the Exchange Act and the rules and regulations promulgated thereunder, except that no representation is made by FPA with respect to information supplied by OCMCS or SJMC for inclusion therein.

* * *

5.19 *Disclosure.* No representation or warranty by FPA or Sub in this Agreement or in any other certificate or document distributed to OCMCS and SJMC contains any untrue statement of a Material fact or omits to state any Material fact necessary to make the statements herein or therein, in the light of the circumstances under which they were made, not misleading.

ARTICLE VI
PRE-CLOSING COVENANTS

* * *

6.2 *Covenants of FPA and Sub.* At all times from and after the date hereof until the Closing Date, each of FPA and Sub covenants and agrees that (except as expressly contemplated or permitted by this Agreement, or to the extent that OCMCS and SJMC shall otherwise consent in writing): (i) each of FPA and Sub shall not make any Material changes to its business or structure which would reasonably be expected to have an adverse effect on the

consideration to be received by the OCMCS Stockholders and the SJMC Shareholders; (ii) each of FPA and Sub shall use all reasonable efforts to take all such actions as are necessary to effectuate the transactions contemplated hereby and to fulfill and cause to be fulfilled the conditions to closing under this Agreement; and (iii) each of FPA and Sub shall not take any action to cause the transactions contemplated by this Agreement not to be treated as a tax-free reorganization within the meaning of Section 368(a)(1)(A) and Section 368(a)(2)(D) of the Code.

6.3 *Advice of Changes.* Each party shall confer on a regular and frequent basis with the others with respect to its business and operations and other matters relevant to the Agreement and the transactions contemplated hereby, and shall promptly advise the others, orally and in writing, of any change or event, including, without limitation, any complaint, investigation or hearing by any governmental or regulatory authority (or communication indicating the same may be contemplated) or the institution or threat of litigation, having, or which, insofar as can be reasonably foreseen, could have, a Material Adverse Effect on OCMCS, SJMC, FPA or Sub, as the case may be, or on the ability of OCMCS, SJMC, FPA or Sub, as the case may be, to consummate the transactions contemplated hereby.

* * *

ARTICLE VII
CONDITIONS TO CLOSING

7.1 *Conditions to the Obligations of the Parties.* The respective obligations of each party to effect the transactions contemplated under this Agreement are subject to the fulfillment prior to or at the Closing of each of the

following conditions, any one or more of which may be waived by written agreement of all parties:

* * *

7.3 *Conditions to the Obligations of OCMCS and SJMC.* The obligations of OCMCS and SJMC under this Agreement are subject to the fulfillment, prior to the Closing, of each of the following conditions, any one or more of which may be waived by OCMCS and SJMC in their sole discretion:

> (a) The representations and warranties of FPA and Sub contained in this Agreement or in any certificates or documents delivered to OCMCS and SJMC pursuant hereto shall in all Material respects be complete, true and correct on the Closing Date (except for such representations and warranties which are qualified by a materiality standard, in which case such representations and warranties shall be true and correct in all respects), with the same force and effect as though such representations and warranties had been made on and as of the Closing Date and each of FPA and Sub shall have delivered to OCMCS and SJMC a certificate, dated the Closing Date and executed on behalf of each of FPA and Sub by its Chairman of the Board, President or any Executive or Senior Vice President, to such effect.

* * *

ARTICLE IX
POST CLOSING OBLIGATIONS

* * *

9.3 *Retention of Books and Records.* For a minimum period of six (6) years after the Closing Date, Sub shall

retain and preserve all books and records with respect to OCMCS and SJMC and the operation of their businesses. For purposes reasonably related to each of the OCMCS Stockholders' and the SJMC Shareholders' respective ownership of OCMCS and SJMC prior to the Closing Date or with respect to this Agreement, such books and records shall, upon any Stockholder's/Shareholder's prior written request therefor be made available for inspection by such Stockholder/Shareholder, his or her authorized representative or agent, during Sub's normal business hours, and the Stockholder/Shareholder shall be entitled to copy, at his or her expense, all or any portion of the contents of such books and records.

* * *

9.6 *Employees.*

(a) From and after the Effective Time, FPA and Sub, and their respective affiliates, will honor in accordance with their terms all existing employment, severance, consulting and salary continuation agreements between OCMCS and SJMC and any current or former officer, director, employee or consultant to OCMCS or SJMC.

(b) From and after the Effective Time, FPA or Sub, as the case may be, shall provide each OCMCS and SJMC employee who becomes an FPA or Sub employee (and, to the extent applicable, the employee's respective eligible dependents) benefits which are substantially similar to those provided under the FPA Employee Benefit Plans applicable to similarly situated employees of FPA or its affiliates. For purposes of determining eligibility to participate, vesting and benefit eligibility in any FPA Employee Benefit Plan (other than the FPA Employee Stock Purchase Plan), FPA shall give each OCMCS and SJMC

employee full credit for the service credited to such employee under the respective OCMCS or SJMC Employee Benefit Plans and FPA shall waive any applicable waiting periods under the FPA Employee Benefit Plans. Notwithstanding the foregoing, FPA shall provide the OCMCS and SJMC employees with credit of, and shall assume OCMCS's and SJMC's liability with respect to, up to a maximum of 160 hours of accrued vacation.

* * *

ARTICLE X
INDEMNIFICATION

* * *

10.4 *Survival and Limitations.*

(a) The representations and warranties of OCMCS and SJMC, on the one hand, and FPA and Sub, on the other hand, contained in this Agreement or in any document or instrument delivered pursuant hereto shall survive the Closing Date and shall continue in full force and effect until the first anniversary of the Closing Date, except for Sections 3.14 (Taxes) and 4.14 (Taxes) and fraud, which shall survive until the expiration of the applicable statute of limitations thereto.

* * *

IN WITNESS WHEREOF, OCMCS and SJMC and FPA and Sub have duly executed and delivered this Agreement as of the day and year first above written.

[Signatures omitted in printing.]

EXHIBIT 9.5(b)

St. Joseph Medical Group Leadership Council

Maria Minon, M.D.
Nancy Brownell, M.D.
Shashidar Acharya, M.D.
Gary Jenkins, M.D.
Keith Gladstein, M.D.
David Sodaro, M.D.
Dawn Bruner, M.D.
Tom Hryniewicki, M.D.
Lisa Gorab, M.D.
James Strebig, M.D.

EXHIBIT 9.5(c)

St. Joseph IPA Leadership Council

R. William Buster, M.D.
Shashidar Acharya, M.D.
William Collins, M.D.
Richard Pitts, D.O.
Laurence Wellikson, M.D.
Norman Rosen, M.D.
Richard Bond, D.O.
William McMaster, M.D.
Marshall Rowen, M.D.
Bharat Bhimani, M.D.
Maria Minon, M.D.

AMENDMENT NUMBER ONE TO
AGREEMENT AND PLAN OF MERGER

[Omitted in printing.]

* * *

APPENDIX B

[Cowen & Company fairness opinion omitted in printing.]

APPENDIX C

CHAPTER 13 OF THE CALIFORNIA
GENERAL CORPORATION LAW

[Omitted in printing.]

APPENDIX D

DELAWARE GENERAL CORPORATION LAW SECTION 262

[Omitted in printing.]

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 20. Indemnification of Directors and Officers.

[Omitted in printing.]

Item 21. Exhibits and Financial Statement Schedules.

[Omitted in printing.]

Item 22. Undertakings.

[Omitted in printing.]

SIGNATURES

[Signatures omitted in printing.]

EXHIBIT INDEX

[Exhibit Index and Exhibit 5.1 omitted in printing.]

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in this Registration Statement of FPA Medical Management, Inc. on Form S-4 of our report dated March 21, 1997, appearing in the Annual Report on Form 10-K/A of FPA Medical

Management, Inc. for the year ended December 31, 1996, our report dated May 2, 1997, appearing in the Current Report on Form 8-K/A of FPA Medical Management, Inc. dated March 17, 1997, our report dated May 2, 1997, appearing in the Current Report on Form 8-K/A of FPA Medical Management, Inc. dated July 31, 1997, and our report dated May 2, 1997 (except for the 1997 poolings of interests as described in paragraphs 5 through 7 of note 1, for which the date is December 8, 1997), appearing in the Current Report on Form 8-K of FPA Medical Management, Inc. dated December 9, 1997.

We also consent to the reference to us under the heading "Experts" in the Prospectus, which is part of the Registration Statement.

/s/ DELOITTE & TOUCHE LLP
San Diego, California
February 9, 1998

[Exhibits 23.2, 23.3, and 23.4 omitted in printing.]

EXHIBIT 23.5

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in this Registration Statement of FPA Medical Management, Inc. on Form S-4 of our report dated September 30, 1996, on the combined financial statements of Foundation Health Medical Services (a wholly-owned subsidiary of Foundation Health Corporation) and Affiliates as of June 30, 1995 and 1996 and for each of the three years in the period ended June 30, 1996 (such report expresses an unqualified opinion and includes an explanatory paragraph referring to significant related party transactions), appearing in

Form S-4 of FPA Medical Management, Inc. dated February 13, 1997.

We also consent to the reference to us under the heading "Experts" in the Proxy Statement/Prospectus, which is part of this Registration Statement.

/s/ DELOITTE & TOUCHE LLP
Sacramento, California
February 9, 1998

[Exhibits 23.6, 23.7, 23.9, 99.1, and 99.2 omitted in printing.]

[Exhibits B, C, D, and E to Consolidated Third Amended Complaint omitted in printing.]

APPENDIX H
(DISTRICT COURT'S EVIDENCE BY PETITIONERS IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT, PART 1)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. 99-CV-1516 W (AJB)

CHARLES T. MADDEN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE LLP, et al., Defendants.

NAVIN P. AMIN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, et al., Defendants.

[Filed June 17, 2002]

PLAINTIFFS' EVIDENCE IN OPPOSITION TO MOTIONS FOR SUMMARY JUDGMENT BY DELOITTE & TOUCHE LLP AND VOLPE BROWN WHELAN & COMPANY LLC, EXHIBITS A-O

[Exhibits A, B, and C omitted in printing.]

EXHIBIT D

CHARLES T. MADDEN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE LLP, et al., Defendants.

NAVIN P. AMIN, et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, et al., Defendants.

EXPERT DEPOSITION OF WILLIAM HENRY BEAVER

Friday, May 3, 2002

---

[18] Q Did you ever read the merger agreement between the FPA, Orange Coast Managed Care Services and St. Joseph's Medical Corporation?

A No, I did not.

* * *

Q Did you think that may have been relevant in any way to your testimony?

A Not to my testimony.

Q Why not?

A Because I am analyzing when there were significant changes in share price, and what information was revealed to the market at those points in time.

Q Did you consider whether or not the merger agreement between FPA, Orange Coast Managed Care

Service and St. Joseph's Medical Corporation would have proceeded without an audit report of Deloitte & Touche?

[19] MR. MARKS: Objection, beyond the scope of his designated expert testimony, and also vague and ambiguous.

THE WITNESS: No, did I not consider that.

Q (BY MR. BOROWSKY) Did you know whether there was any warranties that were backed up by the Deloitte & Touche audit in a merger agreement with respect to the financial condition of FPA?

MR. MARKS: Same objections.

THE WITNESS: No, I did not.

Q (BY MR. BOROWSKY) Did you ever read the complaint in this case?

A Yes, early in the case.

Q How early in the case?

A It would have been, best I recall, sometime late in 2001.

Q To what extent did you rely on the allegations of the complaint in preparing your report?

MR. MARKS: Objection, overbroad.

THE WITNESS: Only in a very general sense. The reason that I examine the Stevens report is I felt that it was a report that put some specificity as to what the accounting allegations were.

Q (BY MR. BOROWSKY) Do you have an opinion one way or the other, sir, as to whether the merger [20] agreement that is referenced in this complaint in this case would have proceeded without an unqualified audit opinion of Deloitte & Touche regarding the financial statements of FPA?

MR. MARKS: Objection, asked and answered.

THE WITNESS: That would be beyond the scope of my testimony.

Q (BY MR. BOROWSKY) Let me direct you to Exhibit 7 to your report. What is Exhibit 7 to your report, sir?

A Exhibit 7 to my report is excerpts from analysts' reports and registration statement that described the transactions that are known as the Guaranteed Access Payments.

Q Have you ever heard of the term Guaranteed Access Payments independent of the work you did in this case?

A Not that I recall.

Q Did you, in reviewing – so what was your purpose of having this Exhibit 7 as part of your report?

A One of the important items that we know in analyzing stock price behavior is that the stock price responds to information when it becomes publicly known. As I proceeded in my analysis, I discovered that the Guaranteed Access Fund payments had been extensively [21] discussed, not only in the registration statements, but in the analysts' reports. That the merits of the accounting treatment for this transaction had been heavily discussed

in the analysts' reports as well. And hence, the major features or nature of what this transaction was was known to the market from late 1996 through 1997.

Q Did you give any consideration as to how many of these analysts' discussions that are referenced in Exhibit 7 regarding the Guaranteed Access Fund payments relied on the audit report of Deloitte & Touche?

MR. MARKS: Objection, it's vague as to the audit report. It's also overbroad.

THE WITNESS: I did in the following sense, that the analysts appear to discuss the transaction in terms of its substance in value to the firm. And alternative accounting treatments were openly discussed by the analyst community. The cash flows associated with the transaction were, were known as well. And as a result the basic nature of the transaction was reflected in share price.

MR. MARKS: When you say firm in your answer, do you mean FPA Medical Management? You said value to the firm.

THE WITNESS: Yes. If I was making a specific [22] statement about a firm, I meant FPA.

Q (BY MR. BOROWSKY) Did you reach an understanding as to whether or not the analysts that you describe here in Exhibit 7 believed or did not believe that FPA's treatment of the Guaranteed Access Payments was in accordance with generally accepted accounting principles?

A The reading of the analysts' reports indicated that there was a wide variation in reaction to the treatment of the report. I don't know that the analysts were rendering an opinion in terms of conformity or violation to GAAP. In

fact some of the analysts pointed out that they were not accountants. And the range of the analysts' reaction ranged from, from criticism in the case, in the case of CFRA, to in some sense praise for the nature of the transaction and what it would imply for the economic value.

I don't – it's not clear that any of the analysts were rendering a judgment as to conformity to GAAP, but instead were attempting to assess the implications of the transaction for the economic value of FPA.

Q Do you believe that if any of the analysts that are described here in Exhibit 7 who praised the GAAP, the Guaranteed Access Fund treatment, knew that the [23] Guaranteed Access Fund treatment was not in accord with generally accepted accounting principles, that it still praised the Guaranteed Access Fund treatment?

MR. MARKS: Objection, incomplete hypothetical, assumes facts not in evidence.

THE WITNESS: May I hear the question again, please?

[24] (Record read)

A The analysts weren't praising the treatment as much as they were praising the nature of the transaction that they felt made economic sense to FPA. And that was, and that was the nature of their opinions regarding the substance of the transaction. And it is a hypothetical, but there are occasions in which once the analyst community understands the basic economic nature of the transaction, that the issue of conformity to GAAP or not is not a major issue in terms of assessing the value of the company's shares.

Q (BY MR. BOROWSKY) Do you have an opinion in this case as to how important it is with respect to financial reporting of publicly-traded companies for the account – the financial statements to comply with generally accepted accounting principles.

THE WITNESS: May I hear that question again, please?

[24] (Record read)

A I think that's going to vary with the context.

Q (BY MR. BOROWSKY) How does that vary with the context?

A In the case of FPA, for example, the basic cash in-flows that the transaction were going to generate were known and discussed by the analysts, they had also a discussion of the obligations that FPA was incurring in connection with those cash in-flows. And in this context that is the substance of the transaction.

And another good example of this is firms using different depreciation methods. They can produce different accounting numbers, and yet the analyst community may not judge the value of the firm to be any different under those two accounting methods.

Q Did you form an opinion one way or the other whether the financial statements of FPA during the years 1996 and 1997 were materially misleading?

MR. MARKS: Objection, overbroad and beyond the scope of his testimony.

THE WITNESS: That is beyond the scope of my testimony.

Q (BY MR. BOROWSKY) But you did read Mr. Stevens' report?

A Yes, I did.

[25] Q Did you also read his rebuttal report?

A Yes, I did.

Q Would it make a difference in your opinion that you've given in this case as to whether or not the financial statements of FPA were materially misleading with respect to the Guaranteed Access Fund payments?

MR. MARKS: Objection, overbroad.

THE WITNESS: In your question what do you mean by the term "materiality"?

Q (BY MR. BOROWSKY) Well, it was materially misleading, because it was not in violation of guaranteed access, of generally accepted accounting principles and materially overstated revenue. Would that make a difference to the opinion you've given in this case?

MR. MARKS: Objection, vague and ambiguous, overbroad.

THE WITNESS: I'm not rendering an opinion as to whether the transaction was or was not in conformity with generally accepted accounting principles. It is my belief that in this context the basic features of the Guaranteed Access Fund payments were known and discussed. And that the particular accounting treatment used would not be material information in terms of an effect on share price.

[26] Q (BY MR. BOROWSKY) Okay. Let me direct your attention to paragraph eight of your Exhibit 7. I'm sorry, paragraph H. You have a reference here to the report of Needham & Company. And this is one example of an analyst that you believe understood the Guaranteed Access Fund payments; is that right, that's why you have him here?

MR. MARKS: Objection, misstates the testimony.

THE WITNESS: No, that's not why I have it there. The purpose of the entire section is to show what the total mix of information was as represented by the analyst community, and does not necessarily single out one company to the exclusion of the other. So it's the sum total of the information that's important to my report.

Q (BY MR. BOROWSKY) Okay. Well, looking at this section H of Exhibit 7 under the Quote sections as you have it in the report, it states, "The Guaranteed Access Payments have been reviewed by Deloitte & Touche, FPA's accountants, which has classified them as revenue under GAAP. The payments are received for services rendered. FPA has recognized revenues of $10 million in 4Q96 and has incurred $9.4 million of costs, so that the EPS contribution in the quarter was only one cent."

Do you know to what extent Needham & Company's [27] recognition that Deloitte & Touche reviewed the Guaranteed Access Payments had an impact on the report?

MR. MARKS: Objection, vague and ambiguous, calls for speculation.

THE WITNESS: No, I don't.

Q (BY MR. BOROWSKY) Let's take the next analyst report you have here, section I, Smith Barney.

"We believe FPA's stock has come under pressure due to the accounting treatment of some GAP payments related to the Foundation Health staff model acquisition in late 1996. The GAP payments comprised $9.6 million or 4.3 percent of total 1Q97 revenues. We believe that the issue has been overblown and that there is no accounting impropriety related to these payments. Firstly, FPA did receive sign off from Deloitte & Touche, the company's accountants, regarding the revenue recognition for GAP."

Do you know to what extent Smith Barney relied on Deloitte & Touche's sign-off of the Guaranteed Access Payments in rendering its report?

MR. MARKS: Same objection, assumes facts not in evidence, calls for speculation.

THE WITNESS: No, I don't, beyond what the quotation cites, which cites a total of three reasons.

Q (BY MR. BOROWSKY) Do you know why it cited [28] Deloitte & Touche's sign-off as the first reason?

A No.

Q Let's take the next report you have here, paragraph J. This is another report of Needham & Company, May 1, '97. Here it states, "We find that FPA and FHS were creative in structuring a transaction that otherwise could not have happened and that enhances the prospects of both companies. Through the transaction, FPA has now acquired the premier networks in these markets and can now turn them around. Accordingly, we credit both of them for creativity instead of suspecting them of inaccurate

accounting. Deloitte & Touche, FPA's auditors, have reviewed the transaction carefully and has also approved of its appropriateness under GAAP."

Do you see that, sir?

A Yes, I do.

Q All right. Do you know to what extent Needham & Company in this report relied on Deloitte & Touche having reviewed the transaction carefully and approving it?

MR. MARKS: Same objections.

THE WITNESS: Well, again, I think the quote speaks for itself. And the earlier part of the quote is clearly talking to the economic substance of the transaction rather than the accountant treatment.

[29] Q (BY MR. BOROWSKY) Do you know why then, sir, it even referred to Deloitte & Touche?

A I don't know specifically. It's presumably reflecting what their perceptions are.

Q Let me direct your attention to paragraph Q, it's on the bottom of page ten and top of page 11. You have a reference here to the analyst report performed by UBS Securities on July 18th, '97. Do you see what I'm looking at, sir?

A Yes, I do.

Q Let me quote this for the record. "This week, the stock has backed off to $24.63. Outside of profit taking, the only explanation for this week's trading pattern appears to be a report issued by the Center for Financial Research & Analysis (CFRA) questioning FPA's accounting. We view

the report as essentially a rehash of issues that are familiar to the Street, and are not concerned with any issues raised by the report. In particular, CFRA questions FPA's accounting treatment of the December 1996 acquisition of a $200 million business from Foundation. As we have stated previously, this treatment has passed muster with FPA's accountants (Deloitte & Touche) and has been included in filings received by the SEC, implying their approval."

Do you know, sir, what USB's conclusion here [30] would have been had the treatment of the Guaranteed Access Funds not passed muster with Deloitte & Touche?

MR. MARKS: Objection, incomplete hypothetical, calls for speculation, assumes facts not in evidence.

THE WITNESS: No, I don't. That would be pure speculation.

It's important to point out that in all of these discussions, since they were – the issues were widely debated, that if there was a stock price reaction it would have occurred during these points in time. Because this is when the information is arriving regarding what the substance of the transaction is.

Q (BY MR. BOROWSKY) Do you know, sir, whether FPA could have even traded the stock without an unqualified audit report of Deloitte & Touche during the years 1996 and 1997?

MR. MARKS: Objection, incomplete hypothetical, calls for speculation.

THE WITNESS: No, I do not.

Q (BY MR. BOROWSKY) Do you know if FPA could have ever acquired the stock of Orange Coast Managed Care Services essentially as its medical corporation without an unqualified audit opinion of Deloitte & Touche?

MR. MARKS: Same objections.

[31] THE WITNESS: No, I don't.

Q (BY MR. BOROWSKY) Did you consider what impact there would be on the price of FPA's stock in 1997 or 1998 if FPA's auditors, Deloitte & Touche, had issued a going concern warning?

MR. MARKS: Objection, it's overbroad, vague as to time. It's an incomplete hypothetical.

THE WITNESS: No, I have not.

Q (BY MR. BOROWSKY) What is a going concern warning?

A A going concern warning is a statement that there are some – that there is, well, some sufficient evidence to believe that the going concern assumption on which the financial statements have been prepared may not be an assumption that will hold true.

MR. MARKS: Just for future, just give me a little bit of time to interpose an objection.

I would interpose one after the fact that it's beyond the scope of your expert testimony, and it's vague and ambiguous as to the phrase "going concern warning."

* * *

[34] Q (BY MR. BOROWSKY) Have you seen the indictment that has been filed against Mr. Steven Mark Lash, the CFO of FPA?

A No, I have not.

Q Have you been informed as to whether Mr. Lash, the CFO of FPA, was indicted for any reason?

(Mr. Snider is now present.)

A No.

MR. BOROWSKY: Let's go off the record for a minute.

(Off the record)

[35] Q (BY MR. BOROWSKY) All right. Professor Beaver, I'm reading a portion of the indictment with respect to Mr. Lash, a Grand Jury indictment against Mr. Lash. And one of the allegations of the indictment is, "Mr. Lash intentionally reported fictitious earnings for FPA to the public investment bankers and Wall Street analysts and FPA's lenders."

Would that have any impact on the conclusions you've reached today?

MR. MARKS: I would object. It assumes facts not in evidence and it's an unproven allegation from a much more extensive indictment.

THE WITNESS: It would not have an effect on my analysis.

Q (BY MR. BOROWSKY) Another allegation in the indictment is that "Mr. Lash intentionally concealed from

the public investment bankers and Wall Street analysts and FPA's lender material facts about FPA's liabilities."

Would that have an impact on any opinions you've reached in the report?

MR. MARKS: Same objections.

THE WITNESS: Well, it strikes me the allegations are fairly far afield from the Stevens report, which is the allegations that I focused on. So [36] these statements that I would make with respect to the Stevens report would not be affected in any way.

Basically the total, the second part of my analysis was to analyze the total mix of information that was coming to the market, and that total mix of information is not altered in any way. And so that conclusion would not be affected either.

Q (BY MR. BOROWSKY) Did you read the letter of Mr. Lash, the letter of Mr. Lash to Sean Conlon of Banque Paribas of March 4th, 1997 to which was attached a memorandum of Mr. Lash to Mr. Conlon of March 4th, 1997?

A Not that I recall.

* * *

[40] THE WITNESS: Well, it calls for speculation, but I mean the SEC requires that financial statements be audited. And that would give them a natural interest in the topic.

Q (BY MR. BOROWSKY) And SEC, when you say the SEC requires financial statements to be audited, do you

mean audited in accord with generally accepted accounting principles and generally accepted auditing standards; is that correct?

MR. MARKS: Objection, vague and ambiguous. I think it confuses those two concepts.

THE WITNESS: It certainly means in accordance with generally accepted accounting principles. I don't know that it's explicit with respect to the auditing standards.

Q (BY MR. BOROWSKY) When I mentioned to you today that Mr. Lash had been indicted for the various things I read to you from this indictment, is that the first you heard of it?

A Basically, yes.

Q I don't want to be tedious, but when you say basically yes, is this the first time?

A Yes. I'm sorry.

* * *

[Exhibit E omitted in printing.]

EXHIBIT F

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

No. 99-CV-1516-W (AJB)
(Consolidated with 99-CV-1376-W)

CHARLES T. MADDEN, an individual, et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, a Limited Liability Partnership, et al., Defendants.

NAVIN P. AMIN, an individual, et al., Plaintiffs,

v.

DELOITTE & TOUCHE, a Limited Liability Partnership, et al., Defendants.

DEPOSITION OF STEPHEN J. DRESNICK, M.D.

Friday November 30, 2001

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* * *

[18] Q. And you took over with – was it about March 25, March 26, 1998?

A. March 26th.

Q. March 26, 1998?

During the period between November 1, 1996 and March 26, 1998, while you were a director and vice-chairman of the board of directors, did you attend meetings of the board of directors of FPA?

A. Yes, I did.

Q. During that period of time – how many meetings do you believe occurred between November 1, 1996 and –

A. I'd have to review the minutes of the board.

Q. Was the purpose of any of those meetings to review the financial condition of FPA?

A. My recollection is that at each board meeting, we would review the financial results of the previous quarter.

Q. Did representatives of Deloitte & Touche attend any of these meetings?

A. At a certain point in time – I don't recall exactly when – a representative of Deloitte & Touche was present at each board member [19] (sic) for a period of time.

Q. Can you tell me what period of time that was.

A. I'm not sure we're saying the same thing.

MR. KELLOGG: The period of time during a board meeting.

THE WITNESS: During a board meeting.

MR. BOROWSKY: I see.

BY MR. BOROWSKY:

Q. Let me make sure I understand. For a period of time of each board meeting that you attended, there was a representative of Deloitte & Touche there. Is that right?

A. I guess I have to say for a period of time – actually, at my suggestion – I had asked that a representative of Deloitte & Touche be present at a particular board member (sic) to address a particular issue, and then suggested we have a representative of Deloitte & Touche

at each board member – each board meeting subsequent for the period of time in which we discussed financial results of the company. And my recollection is that did occur.

* * *

[20] Q. Which representatives of Deloitte & Touche attended the board meetings to which you just referred at FPA?

A. I honestly couldn't tell you which one might have – which one or both might have been at any particular meeting. Sometimes they were there by phone, a conference call, rather than being physically present. So I honestly don't recall.

Q. The two individuals – or the individuals that you are referring to that were representatives of Deloitte & Touche that attended these meetings either by phone or in person, did they include Mr. Hamman and Mr. Hartley?

A. I couldn't tell you. I think I only met one of them. I don't remember which one was which – on one occasion.

Q. Do you remember ever meeting Mr. Hamman or [21] Mr. Hartley?

A. I remember meeting one of them. I don't remember which one I met.

Q. Why did you recommend that representatives of Deloitte & Touche attend these meetings?

A. Well, there was two reasons. At Sterling, the company that I founded, we were a public company before we sold to – sold the company to FPA. And it had been my custom to have the auditors present for parts of the board

meeting to address any issues the board members might have. So it was, in part, my own particular custom.

And the specific issue that had come up was – the issue of guarantied access fund payments to FPA had been an issue that had come up, and I felt that it would be important that the board hear a report from the auditors that that treatment was correct.

Q. Do you remember when the auditors appeared before the board to discuss the correctness of the guarantied access fund payments?

A. I could look through the board minutes and tell you. I don't offhand exactly recall –

Q. Can you tell me what year it was? Was it 1997?

[22] A. My recollection, it was in 1997.

Q. Can you tell me what season of the year?

A. Spring, my recollection, but –

Q. At this particular board of directors meeting, did the representative of Deloitte who appeared, appear in person?

A. Yes.

* * *

[29] Q. Was Mr. Lash there as well?

A. Yes.

Q. Was it one or two people from Deloitte & Touche that appeared?

A. My recollection, it was one person.

Q. But you don't remember the name of that person?

A. I don't.

Q. Do you know whether it was Mr. Hamman or Mr. Hartley or either of them?

MR. KELLOGG: Objection. He doesn't remember.

THE WITNESS: If I had board minutes, I could tell you in a second.

MR. BOROWSKY: I'll go over those with you in a few minutes. I'm trying to understand your recollection. Because the board minutes might not discuss everything.

BY MR. BOROWSKY:

Q. Do you remember what was said by the representative of Deloitte & Touche with respect to the guarantied access funds?

[30] A. My recollection is that the representative of Deloitte & Touche said that they felt that they had reviewed the elements of the guarantied access fund and felt that the way the company had been treating it was correct.

Q. Did you rely on that explanation?

A. Yes, I did.

Q. What is your understanding, sir, of why FPA went bankrupt within three or four months of the merger between FPA and OCMCS and SJMC?

A. The primary issue was a lack of cash, which really set off a domino effect in the company.

Q. When did you first discover this lack of cash?

A. Towards the end of April of 1998.

* * *

[87] Q. This was the meeting – this March 25th meeting, as reflected on the first – second page, that Dr. Flam and Mr. Lash resigned?

A. Yes.

Q. And you became chief executive officer?

A. Yes.

* * *

[132] MR. BOROWSKY: We're now at Exhibit 18.

(Exhibit No. 18 was thereupon marked and thereafter remarked as Exhibit No. 105.)

BY MR. BOROWSKY:

Q. Exhibit 18 consists of six pages. They are consecutively Bates stamped. The first is Bates stamped L&W28548 and the final is Bates stamped L&W28553. Have you seen this before?

A. Yes, I have.

Q. Can you tell me what it is.

A. It is our press release announcing first quarter of 1998 earnings.

Q. Can you tell me everything you remember doing to prepare this press release.

A. Everything I did?

Q. Yes.

A. Well, the actual preparation of the press release would have been initially done in draft form by Jack Greenman and Doug Kerner, along with Jim Lebovitz. And then I would review – my recollection is I then reviewed it, made changes or comments in the narrative portions. Obviously I didn't participate in the preparation of the numbers, themselves.

[133] Q. Who did?

A. Doug Kerner, Jack Greenman, the finance staff.

Q. I'm sorry. Doug Kerner, Jack Greenman and who?

A. The finance department.

Q. In the third paragraph, you say, "While I am disappointed in the first quarter results, I am encouraged in the strength of most of our operations." Were you surprised about the first quarter results?

A. Well, not by the time we released them. I had already spent the last week and a half coming to grips with what the earnings of the company were going to be that quarter.

Q. But when you first began the realization about what the first quarter results would be, were you surprised?

A. Initially, when we did the first draft of this, we thought the earnings were going to be earnings of about ten cents per share. Obviously, it came in much less than that. I was disappointed. In part, as I said, part of it was a change in the way we were going to account for certain things. So there was a piece that was going to knock that down. [134] The other piece was that – you know, we were

coming to grips with, I think, some fairly significant operational issues, like the losses that we were incurring in Arizona and Sacramento and Vegas.

Q. The ten cents a share, those were the earnings per share?

A. That's what our initial draft – I think it had been earlier in the week – had shown.

Q. What were the earnings per share in the prior quarter?

A. I'd have to go back and look. I mean we have the previous year –

Q. It was substantially higher.

A. No, lower. We lost more money the previous year.

Q. You lost more money in 1997.

A. That's correct. That's what it says.

Q. We'll go into those financial statements in a moment.

A. Okay.

Q. Getting back to the first page of this exhibit, the last paragraph says, "The company stated that management was completing the assessment of all regional operations and their respective contribution of profit. As a result of this [135] assessment, the company also stated that in the second quarter of 1998, it anticipates recording a pretax charge for one time non-recurring charges of up to approximately $200 million, which are expected to consist of the following items: Approximately $125 million representing goodwill impairment, an approximately $40

million write-down of shared risk and other receivables, and approximately $35 million for additional severance payments, anticipated office consolidation and other miscellaneous charges," end quote.

The $125 million proposed writedown with respect to goodwill impairment, who did that analysis?

A. Doug Kerner and Jack Greenman.

Q. Did you review that analysis?

A. I don't recall the specifics of it. I may have, I don't know.

Q. Do you know what portion of that proposed goodwill impairment was attributable to the Foundation transaction?

A. A significant portion.

Q. Can you give me a range?

A. I would say probably 75 percent at least.

* * *

[136] Q. Do you know why there was a proposed write-down of the goodwill in connection with the Foundation transactions?

A. I think we paid a lot of money for the Foundation business. You know, it was losing money. It wasn't performing according to its pro forma. And the finance staff felt that the goodwill that was attributed to it should be – there should be a charge-off against it. It was a non-cash item.

Q. Would Mr. Greenman be knowledgeable – do you believe that Mr. Greenman would be knowledgeable as to these proposed write-downs?

A. Yes. If he remembers them, yes.

Q. Let's go into the financial statements that are attached to this exhibit. You explained a moment ago that the earnings were less the prior year than they were as of this quarter that you are referencing in your press release.

A. Yes. March 30, 1997, showed a net loss per [137] share of 60 cents versus a net loss of 20 cents per share for March 31, 1998.

Q. And you're looking at the page that's Bates stamped below it, L&W28551.

A. Yes.

Q. Looking at the first page of the financial statements which is attached to your press release – it has the Bates stamp on the bottom L&W28550 – the assets are recorded to be higher on March 31, 1998 than December 31, 1997. Is that correct?

A. The assets? Yes.

Q. And the stockholders' equity according to this document, as of December 31, 1997, was 180,160,000. Is that right?

A. It's in thousands. So 180 million.

* * *

Q. As of March 31, 1998, the stockholders' equity was 213,920,000. Is that correct?

A. That's correct. Your question?

* * *

[139] Q. Thomas Davis was part of the Foundation transaction as well.

A. They both were, yes.

Q. So the combined numbers, 88,871,000 and 176,568,000, would be the amount of goodwill allocated to the Foundation transaction, based on your understanding of this document?

A. Whatever this was represented to be, yes.

MR. SNIDER: Did you say Foundation transaction or transactions plural?

MR. BOROWSKY: I said transaction, but I should have said transactions.

MR. SNIDER: I think there was more than one transaction.

THE WITNESS: That's true.

BY MR. BOROWSKY:

Q. That would be – the combined sum of these numbers, 176 million and 88 million, approximately, was the amount of goodwill allocated to the Foundation transactions in '96.

A. That's correct. There was another piece of Foundation business that occurred prior to that, that I don't believe is reflected in these numbers. It was a Florida piece that I don't believe is reflected here.

[140] MR. SNIDER: Earlier in 1996.

THE WITNESS: That's correct.

MR. BOROWSKY: This is next in order.

(Exhibit No. 20 was thereupon marked and thereafter remarked as Exhibit No. 107.)

BY MR. BOROWSKY:

Q. Exhibit 20 is a memorandum of Jack Greenman to a number of people, with a copy to you. It's dated June 13, 1998. Did you receive this on or about June 13, 1998?

A. Yes.

Q. Did you review it with anyone?

A. I reviewed it with Jack Greenman.

Q. Did you understand what the purpose of this memorandum was?

A. Yes.

Q. What was that purpose?

A. It summarizes our discussion vis-a-vis giving back Sacramento and Thomas Davis Medical Group to Foundation.

Q. And writing off the book value of the related assets, including goodwill.

A. Well, we would write off – that's correct. . . .

* * *

EXHIBIT DRESNICK 18

Company: FPA Medical Management, Inc.
Investor Contact: Stephen J. Dresnick, MD, FACEP
President and Chief Executive Officer
305-FPA-3767

FPA MEDICAL MANAGEMENT, INC. ANNOUNCES
1998 FIRST QUARTER RESULTS

San Diego, California, May 15, 1998 . . . FPA Medical Management, Inc. (Nasdaq:FPAM) today reported financial results for the three months ended March 31, 1998.

FPA's operating revenue for the first quarter ended March 31, 1998 increased 33.0% to $392.2 million compared to $294.9 million for the same period last year. Earnings before interest, taxes, depreciation, amortization and one time charges (EBITDA) increased 1.5% to $15.9 million as compared to $15.7 million in 1997. EBITDA decreased 53.9% from $34.5 million reported for the fourth quarter of 1997. The fourth quarter EBITDA included approximately $18 million related to the recognition of excess reserves for incurred but not reported medical claims (IBNR) based upon the Company's year end audit. Net income for the first quarter was $449,000 or $0.01 per share (assuming a 38% tax rate and excluding non-recurring charges of $7.6 million related to the acquisition of St. Joseph Medical Corporation and $7.9 million related to executive severance), compared to a net income of $2.6 million or $0.06 per share for the same period last year (excluding one-time merger and restructuring charges of $36.8 million). Including the charges of $15.5 million, the Company reported a net loss of $9.1 million or $0.20 per

share for the three months ended March 31, 1998 compared to a net loss of $24.5 million or $0.58 per share for the same period in 1997. First quarter earnings were negatively impacted by a 45.5% increase in interest expense to $6.4 million from $4.4 million in 1997 due to increased borrowings under the Company's credit facility. Depreciation and amortization also increased 22.0% to $8.7 million from $7.1 million in 1997. The combined effect of increased interest, depreciation and amortization expenses resulted in a decrease in pre-tax income of $3.6 million or $0.08 per share (after tax) as compared to 1997. In addition, earnings per share were negatively impacted by a 10% increase in basic shares outstanding. Both 1998 and 1997 financial results have been restated to reflect pooling of interests transactions.

"While I am disappointed in the first quarter results, I am encouraged by the strength in most of our operations," stated Stephen J. Dresnick, MD, FACEP, who was elected President and Chief Executive Officer of FPA on March 25, 1998.

The Company stated that management was completing the assessment of all regional operations and their respective contribution to profit. As a result of this assessment, the Company also stated that in the second quarter of 1998 it anticipates recording a pre-tax charge for one-time non-recurring charges of up to approximately $200 million, which are expected to consist of the following items: approximately $125 million representing goodwill impairment; an approximately $40 million write-down of shared risk and other receivables; and approximately $35 million for additional severance payments, anticipated office consolidation and other miscellaneous charges

Based upon the Company's current assessment, management anticipates no additional restructuring charges in 1998.

The Company's Sacramento and Arizona (Thomas Davis Medical Centers) regional operations incurred a pretax loss of approximately $5.0 million that negatively impacted first quarter results. The Company is aggressively working towards solutions in these markets and is committed to either achieving profitability or exiting those markets.

Douglas Kerner, Acting Chief Financial Officer, added, "We have launched a major internal improvement program throughout the entire Company to improve profitability and cash flow. Steps taken to date include a freeze on hiring and capital spending, a workforce reduction and establishing more effective procedures to control overhead expenses. We estimate these steps, when fully implemented by the fourth quarter should reduce general and administrative expenses that should result in savings by approximately $25 million on an annualized basis." The Company also reported that it is in the process of closing its Long Beach, California facility, consolidating its credentialing department to Miami, Florida and aggressively pursuing other office consolidations and closures. In addition, the Company reported that the anticipated write-down of goodwill is expected to result in reduced amortization charges of approximately $5 million on an annualized basis.

Dr. Dresnick stated, "We continue to develop plans to achieve operational improvements including an aggressive claims audit and recovery process where claims are paid on their behalf by third parties. I am confident that these

overhead reductions coupled with our increased focus on medical cost management initiatives should result in substantially improved financial results in the second half of 1998."

FPA Medical Management, Inc. is a national physician practice management organization that organizes and manages primary care physician networks to contract with HMOs and other prepaid insurance plans to provide physician and related health care services and provides contract management support services to hospital emergency departments.

* * *

[Disclaimer of "forward-looking statements" and financial statements omitted in printing.]

[Exhibit Dresnick 20 omitted in printing.]

[Exhibits G, H, and I omitted in printing.]

EXHIBIT J

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF CALIFORNIA

CHARLES T. MADDEN, an individual, et al., Plaintiffs,

v.

DELOITTE & TOUCHE, LLP, a limited liability partnership, STEPHEN J. DRESNICK, an individual, SETH FLAM, an individual STEVEN M. LASH, an individual, JAMES A. LEBOVITZ, an individual, VOLPE BROWN WHELAN & COMPANY, LLC, a limited liability company and DOES 1-100, inclusive, Defendants.

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* * *

DEPOSITION OF JAMES A. LEBOVITZ

Friday December 21, 2001

9:30 A.M.

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* * *

[56] [Q.] There were some letters that were sent to the Securities Exchange Commission in 1996 regarding the accounting treatment of guaranteed access funds. Were you aware of any of that documentation?

A. If those were in connection with the filing of the registration statement related to the Foundation transaction and they were – yes, I would be – I would have been aware of those, yes.

Q. Were those letters reviewed with Deloitte & [57] Touche?

A. You know, I don't know all the letters, but in the normal course when the company filed a registration statement, got back comments from the SEC, in particular the comments relating to financials would be reviewed by Deloitte & Touche, yes.

* * *

[72] Q. Let me direct your attention to another document. This document is headed "FPA Medical Management, Inc. 1997 Budget Retreat January 13 to 14, 1997," and it consists of a number of pages marked consecutively beginning with L&W26932 through and including L&W27002.

(Lebovitz Exhibit 243 was marked for identification.)

Q. Before you look at the document, can you tell me if you ever attended the budget retreat that is referenced in the first page of this document?

A. I think I did.

[73] Q. Where was that budget retreat held?

A. I was going to ask you. I think it was in Florida.

Q. And who participated in this?

A. Oh, boy. I would think there would be 10, 15 maybe, or even 20 people.

Q. You were there?

A. I'd love to check my calendar, but I'm pretty sure I was there. Let me just make sure I was there.

Q. I have some pages of the calendar, but I don't have pages that go back that early.

Mr. Lash was there?

A. I believe he was there. January – yeah, he was there.

Q. Who else do you remember being there?

A. I think that – I will give you my best guess.

Q. Your best recollection.

A. My best recollection.

MR. PACE: Don't guess. If you know, you need to – well. Okay. I understand. I'm sorry.

A. I can't see people – I would think that Brian Barnard would have been there.

[74] Q. Brian who?

A. Barnard. He was head of Florida operations.

Dr. Dresnick, Jack Greenman, and I would think a lot of the regional operators would be there.

Q. Was anyone from Deloitte & Touche there?

A. I don't remember that.

Q. You don't know one way or the other?

A. I don't know one way or the other.

Q. What was the purpose of the budget retreat?

A. I think it was to set the budget for the next year.

Q. Do you remember where it was held in Florida, the retreat?

A. I think it was held in the company's offices.

Q. And the first page of this exhibit refers to January 13 and 14, 1997. Do you remember what the hours were each day?

A. I'm sorry, I don't.

Q. Did you ever see this document before, Exhibit 243?

A. Before today?

Q. Yes.

A. I think I did, yes.

Q. When do you remember first seeing it?

[75] A. I think I would have seen it at the meeting.

Q. January 13 and 14, 1997?

A. Yes.

Q. Let me direct your attention to Page 4. It is also marked L&W26936 of Exhibit 243. The heading is "FPA Medical Management, Inc. Consolidated 1997 Budget," and the first line has "Target, Budget, Variance," and then on the left it says "EBITDA (w/o GAF)." Do you know what that entry references?

A. Do I know what EBITDA stands for?

Q. Yes. Do you know what E-B-I-T-D-A is?

A. I think it stands for earnings before interest, taxes, depreciation. I think it is adjustments, but I'm not sure.

MR. ROOT: Amortization.

A. Amortization.

THE WITNESS: Thanks.

Q. Do you know what w/o stands for? Can we assume that's without?

A. I think that is a fair assumption.

Q. And "GAF," do you know what that references?

A. I would think that would refer to guaranteed access fund.

Q. And do you know what the guaranteed access fund related to?

[76] A. I think we talked about it earlier.

Q. The Foundation transaction?

A. Yes.

Q. And do you understand why there was a reference in this budget retreat to earnings before interest, taxes, depreciation and amortization without guaranteed access funds?

A. Do I know why it was like that? No, I don't know why it was like that.

Q. Do you know why it was presented the way it is here?

A. I don't know why it was presented like this.

Q. Do you remember the discussion during this budget retreat as to the impact of guaranteed access funds on earnings per share?

A. No, I don't.

Q. Do you know what earnings per share references?

A. Yes, I think I do.

Q. And can you describe that, please?

A. Earnings per share is a – you get that by dividing earnings by the waited average number of shares and come up with a per share number.

Q. Did you have an understanding of what the relevance of earnings per share was with respect to [77] analysts' expectations regarding publicly traded stock?

A. Yes.

Q. And what is your understanding of that, sir?

A. That's the way they, analysts, target earnings per share for public companies.

Q. With respect to the presentation that is on this page that I just identified as part of Exhibit 243 marked L&W26936, do you remember the discussion that was held at this budget retreat with respect to guaranteed access funds and earnings before interest, taxes, depreciation and amortization?

A. No, I don't.

Q. Look at the bottom of this document. There is a rectangle with the letters GAF in the upper left-hand corner and there is an entry "net income W/GAF." Did you understand that this was a calculation as to the impact of including guaranteed access funds with respect to earnings per share?

A. That's what I assume now. I have no recollection in looking at this of making that judgment at the end of

the 1997 meeting, but I would agree that it looks like it is with guaranteed access funds.

Q. Do you see that earnings per share without [78] guaranteed access funds according to the column under target is 57 cents and with guaranteed access funds is $1.27?

A. I see that, yes.

* * *

LEBOVITZ EXHIBIT 243
[All pages other than page 4 omitted in printing.]

FPA MEDICAL MANAGEMENT, INC.
CONSOLIDATED 1997 BUDGET

	Target	Budget	Variance
EBITDA (w/o GAF) Corporate [1]	$ (7,620,000)	$ (14,526,906)	$ (6,906,906)
CA Admin [1]	-	(7,006,924)	(7,006,924)
SDMSO [1]	5,749,200	8,902,568	3,153,368
FPACA [1]	-	(1,329,602)	(1,329,602)
LAMSO [1]	5,280,640	6,718,937	1,438,297
SACMSO [1]	2,407,160	9,895,546	7,488,386
FHMG [2]	(4,731,426)	(7,728,229)	(2,996,803)
Total CA	**8,705,574**	**9,452,296**	**746,722**
East Coast	3,043,000	2,303,288	(739,712)
AMCS [3]	3,352,000	4,544,901	1,192,901
TDMC [2]	9,123,426	9,498,723	375,297
TX	9,201,000	10,792,950	1,591,950

FL-Family First [3]	12,132,000	12,313,524	181,524
Sterling	18,615,000	19,035,760	420,760
MI [4]	-	-	-
EBITDA TOTAL	**56,552,000**	**53,414,536**	**(3,137,464)**
D&A	20,351,000	23,177,087	(2,826,087)
Net Interest Inc/(Exp)	(11,787,000)	(7,115,005)	4,671,995
EBT	**24,414,000**	**23,122,444**	**(1,291,556)**
Taxes	10,195,906	9,248,978	946,929
Net Income	**$ 14,218,094**	**$ 13,873,467**	**$ (344,627)**
Outstanding Share (F/D)	24,975,000	30,076,000	(5,101,000)
EPS	**$ 0.57**	**$ 0.46**	**$ (0.11)**

GAF	**29,900,000**	**29,900,000**	
Net Income W/GAF	**$ 31,631,094**	**$ 31,813,467**	**$ 182,372**
EPS	**$ 1.27**	**$1.06**	**$ (0.21)**

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[1] Projections prepared on a consolidated West Coast basis only. Regionals allocated on a percentage of capitated revenue basis.

[2] Target includes allocation of FH MSO pro forma based on membership.

[3] Includes Foundation IPAs.

[4] No 1997 budget submitted. Removed targeted EBITDA of $533K 1/3/97.

[Lebovitz Exhibits 266-271 and 277 omitted in printing.]

[Exhibits K, L, M, N, and O omitted in printing.]

APPENDIX I

(DISTRICT COURT'S EVIDENCE BY PETITIONERS IN OPPOSITION TO MOTION FOR SUMMARY JUDGMENT, PART 2)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. 99-CV-1516 W (AJB)

CHARLES T. MADDEN, *et al.*, Plaintiffs,

v.

DELOITTE & TOUCHE LLP, *et al.*, Defendants.

NAVIN P. AMIN, *et al.*, Plaintiffs,

v.

DELOITTE & TOUCHE LLP, *et al.*, Defendants.

PLAINTIFFS' EVIDENCE IN OPPOSITION TO MOTIONS FOR SUMMARY JUDGMENT BY DELOITTE & TOUCHE LLP AND VOLPE BROWN WHELAN & COMPANY LLC, EXHIBITS P–X

Date: July 1, 2002
Time: No oral hearing
Judge: Hon. Thomas J. Whelan

[Filed June 17, 2002]

EXHIBIT P

DEPOSITION OF RICHARD STEVENS

[Testimony omitted in printing.]

STEVENS EXHIBIT 285

MADDEN, *et al.*, Plaintiffs

vs.

DELOITTE & TOUCHE, LLP, *et al.*, Defendants

Report of Richard G. Stevens

Dated this 14th day of January, 2002

/s/ Richard G. Stevens
Richard G. Stevens
Hunter Stevens, LLC
One Market
Spear Street Tower
San Francisco, CA 94105

I. Introduction and Qualifications

I am a Certified Public Accountant, Certified Fraud Examiner, founder and Managing Director of Hunter Stevens, a professional services firm providing various financial and litigation support services. In this capacity, I

serve as a consultant and expert witness concerning a variety of liability and damage matters.

Prior to forming Hunter Stevens in 1995, I had been a partner with Ernst & Young in their special services practice group in San Francisco. The services I had responsibility for included litigation support and special investigations.

Before serving as a partner with Ernst & Young, I had been a consulting partner with Coopers & Lybrand in New York, providing technical advice and support to the firm's approximately 100 U.S. practice offices concerning accounting, auditing, and SEC matters. During my tenure with Coopers & Lybrand in Manhattan, I became a contributing author of *Montgomery's Auditing, 10th Edition*, one of the principal reference books used in the accounting profession. Prior to working for Coopers & Lybrand in New York, I had been an audit partner with Coopers & Lybrand in their San Francisco and San Diego offices.

I have testified as an expert witness in State and Federal Courts. A more detailed summary of my training, past experience and prior testimony is shown in Exhibit 1. Hunter Stevens is being compensated for the time I spend on this matter at the rate of $390 per hour.

II. Assignment

I have been asked by Counsel for the Plaintiffs in this matter to analyze the consolidated financial statements of FPA Medical Management, Inc. ("FPA" or the "Company") for the year ended December 31, 1996 and the consolidated financial statements of FPA for the nine months ended September 30, 1997 included in or incorporated by

reference in FPA's Registration Statement on Form S-4 ("S-4") that became effective February 17, 1998.

In that regard, I have been asked to form an opinion regarding whether or not FPA's consolidated financial statements included in or incorporated by reference in the S-4 were prepared in accordance with generally accepted accounting principles ("GAAP").

III. Materials Reviewed

In the course of this assignment, my staff and I have reviewed an extensive volume of deposition testimony, exhibits, Deloitte & Touche ("D&T") workpapers, and documents produced by FPA. We have reviewed over 20 boxes of documents produced in this case. As discovery is ongoing, I am still reviewing materials as they are made available and will continue to do so as they are provided to me. I will supplement this report as necessary.

IV. Background

FPA was a national physician practice management company which, through its network of primary care physicians and affiliated professional corporations, contracted with heath [sic] maintenance organizations, and other prepaid health insurance plans to provide and manage physician and related healthcare services to enrollees who selected FPA's network of primary care physicians. FPA also provided contract management services to hospital emergency departments in several states. FPA's revenues grew from $58 million in 1994 to $440 million in 1996.

During 1996, FPA acquired fifteen (15) entities, including seven (7) from Foundation Health Services, Inc.

("Foundation"). FPA disclosed the acquisition of these entities in its December 31, 1996 consolidated financial statements presented in Form 10-K 405 filed with the Securities and Exchange Commission ("SEC") on March 31, 1997. The disclosure (Note 11 to the consolidated financial statements) about the acquisitions is presented below:

> *"Following is a summary of material acquisitions consummated during 1996 by the Company, one of its subsidiaries, or one of the Professional Corporations. Such acquisitions were accounted for using the purchase method of accounting. Goodwill totaling approximately $242 million was recorded, which is being amortized over periods ranging from 25 to 30 years. In connection with these acquisitions, the Company issued (i) FPA Common Stock valued at $51.6 million, (ii) notes payable of $163.8 million, and (iii) cash of $19.4 million.*

VIP, IPA, A Professional Corporation	*January 1996*
Foundation Health IPA	*January 1996*
Century Family Medical Group, IPA	*January 1996*
Century Family Medical Group, Inc.	*January 1996*
Chabot Medical Group IPA	*January 1996*
PhysiciansFirst, Inc.	*June 1996*
Family First Pharmacy, Inc.	*June 1996*
FPA Family Pharmacy, Inc.	*June 1996*
Physicians Medical Group of Florida, Inc.	*June 1996*
FHC IPA, Inc.	*July 1996*
Intergroup IPA, P.C.	*July 1996*
Foundation Health Medical Services (1)	*December 1996*
Foundation Health Medical Group, Inc. (1)	*December 1996*
FHMG/TDMC Medical Group, A Professional Corporation (1)	*December 1996*
Thomas Davis Medical Centers, P.C. (1)	*December 1996*

(1) The Company is in the process of determining the appropriate values to be assigned to the assets acquired and liabilities assumed in connection with these acquisitions. Accordingly, the Company's estimates of these values are subject to revision upon completion of an independent valuation that may result in an adjustment to goodwill."

Foundation made the following disclosures regarding the sale of its Medical Groups to FPA (see Foundation's Form 10-K 405A for the year ended June 30, 1996):

"During fiscal year 1996, the Company revised its strategy of maintaining the Medical Groups. This change in strategy was the result of two primary factors: (1) the Company's inability to generate adequate volume and appropriate patient mix necessary for the Medical Groups to be profitable and (ii) the emergence of large, competitive physician management companies with the necessary patient volume and expertise to manage physician medical groups. These changes lead the Company to adopt a plan in the third quarter of fiscal year 1996 to completely discontinue the operations of this segment."

In late 1997, FPA offered to acquire Orange Coast Managed Care Services, Inc. and St. Joseph Hospital Corporation. The S-4 was filed by FPA in connection with these acquisitions. As stated above, the S-4 contained or incorporated by reference FPA's audited consolidated financial statements for the year ended December 31, 1996 and unaudited consolidated financial statements for the nine months ended September 30, 1997. D&T issued its audit opinion with respect to the December 31, 1996 consolidated financial statements on March 21, 1997 and

signed a consent to have its opinion included in the S-4 on February 8, 1998. D&T completed its audit of FPA's 1997 consolidated financial statements on March 20, 1998, the date the merger with Orange Coast and St. Joseph closed.

In May 1998, less than two months following the close of the merger with Orange Coast and St. Joseph, FPA announced that it would write off $125 million in goodwill and make certain other restructuring adjustments.

Approximately a month later, in June 1998, FPA sought protection by filing a petition for relief under Chapter 11 of Title 11 of the United States Code (Bankruptcy Code).

V. Summary of Conclusions

Based on the work described above, I have reached the following conclusions:

- FPA's 1996 consolidated financial statements included in or incorporated by reference in the S-4 failed to comply with GAAP in that they materially understated FPA's reported loss from operations.
- FPA's interim consolidated financial statements for the nine months ended September 30, 1997 included in or incorporated by reference in the S-4 failed to comply with GAAP in that they materially overstated FPA's reported income from operations.

VI. Reasons supporting the conclusion that FPA's 1996 consolidated financial statements included in the S-4 failed to comply with GAAP.

- Of the alleged $235 million in acquisitions consummated in 1996, $197 million occurred in December

1996. (see the Company's S-4 filed with the SEC on February 13, 1997 concerning the Foundation Acquisitions). Following the December 1996 transaction, Foundation held 16.45% of FPA's common stock. As part of the 1996 business combinations, Foundation agreed to pay FPA $55 million ($45 million related to the December 1996 acquisition and $10 million related to the June and July 1996 acquisitions) under arrangements entitled Guaranteed Access Fund ("GAF") (FPA/DT 18149). The $55 million was to be paid as follows: $16.45 million in 1996; $29.9 million in 1997; and $8.65 million in 1998 (FPA/DT 18115; 18120; 18171; and 18174). The GAF arrangement required FPA to maintain the services Foundation promised its patients through 2026 (L&W39257). The December transaction also called for Foundation to pay FPA $23.7 million in 1997 for guaranteed risk-share amounts, capitation levels, and enrolled members (FPA/DT18174 and 18175; and L&W12446).

- The substance of the 1996 Foundation transactions should have caused FPA to reduce the cost of its acquisitions of Foundation's Medical Groups by the $55 million and $23.7 million referred to above. Doing so would have been consistent with the manner in which Foundation treated the sales. As indicated in Foundation's tax analysis of the transactions, Foundation reflected the $55 million and $23.7 million as a reduction of the sales price and an obligation due FPA (FPA/DT 18144). It also would have been consistent with the fairness opinion the Company obtained from Oppenheimer & Co., Inc. concerning the 1996 Foundation Acquisitions.

- In essence, FPA bought "revenues" in 1996 that it would subsequently recognize in 1996, 1997, and 1998. FPA provided no disclosure concerning the accounting for the receipt of these payments or the relationship of Foundation to FPA.

- By grossing-up the cost of the acquisition of Foundation's Medical Groups, the $55 million and $23.7 million became a "cookie jar" for FPA, allowing it to report revenue on the receipt of payments from Foundation.

For example, FPA recorded the $11.25 million it received in December 1996 from Foundation as 1996 "revenue" even though the December acquisitions closed only days before FPA's year-end (DT11570).

- The impact of the 1996 GAF receipts ($16.45 million) had an even greater impact on FPA's reported loss from operations. The loss from operations reported by FPA in 1996, following the inclusion of the $16.45 million in revenue, was $10.59 million rather than the $27 million which would have been reported if the $16.45 million had not been included in revenue. The inclusion of the $16.45 million in revenue resulted in a distortion of FPA's loss from operations by over 150 percent; thus softening the blow with respect to the Company's reported net loss for 1996.

VII. Reasons supporting the conclusion that FPA's Interim consolidated financial statements for the nine months ended September 30, 1997 included in the S-4 failed to comply with GAAP.

- FPA's interim consolidated financial statements for the nine months ended September 30, 1997 included GAF payments of $24.4 million as revenues (FPA/DT 18174). It also included the additional $23.7 million supplemental payment as revenues (L&W12446). This treatment caused FPA's interim results of operations for 1997 to look much improved over the corresponding period in 1996, when in fact they were not.

- FPA knew the Medical Groups it acquired from Foundation would generate losses for the predicable future, yet during the nine months ended September 30, 1997 FPA capitalized $12.4 million of such losses as goodwill instead of charging the losses to income as incurred (FPA/DT 00304). The $12.4 million added to goodwill was made up of $9 million in actual losses plus $3.4 million of "profit" that FPA erroneously recognized (L&W12446).

- The combination of recognizing revenue on payments received from Foundation and deferral of losses as goodwill caused FPA's 1997 interim results of operations to be false and misleading. Without the $24.4 million and the $23.7 million payments recognized as revenue, along with the deferral of losses as goodwill totaling $12.4 million, FPA's reported income from operations of $9 million for the nine months ended September 30, 1997 would have been a loss of $51.5 million. Any outlook of future operations and respective cash flows was affected by these misstatements.

- Furthermore, while FPA was experiencing a severe liquidity crisis as evidenced by its newly undertaken programs to aggressively reduce costs and generate cash at the time the S-4 became effective on February 17, 1998, the S-4 failed to disclose this fact. The liquidity crisis resulted in FPA seeking bankruptcy protection approximately three months following the merger of Orange Coast Managed Care Services, Inc. and St. Joseph Hospital Corporation with FPA.

[Attachments to Stevens Exhibit 285 omitted in printing.]

STEVENS EXHIBIT 288

MADDEN, *et al.*, Plaintiffs

vs.

DELOITTE & TOUCHE, LLP, *et al.*, Defendants

Supplemental Report of Richard G. Stevens
In response to William W. Holder's Report dated
March 18, 2002

Dated this 17th day of April, 2002

/s/ Richard G. Stevens
Richard G. Stevens
Hunter Stevens, LLC
One Embarcadero
Suite 3700
San Francisco, CA 94111

Introduction

My Report of January 14, 2002 identifies several deficiencies in FPA Medical Management, Inc.'s ("FPA's") consolidated financial statements included in or incorporated by reference in FPA's Registration Statement on Form S-4 that became effective February 17, 1998. These deficiencies are such that said financial statements failed to comply with generally accepted accounting principles ("GAAP").

The Report of William W. Holder takes exception to my Report, expresses the opinion that the consolidated financial statements of FPA for 1996 complied with GAAP,

and that Deloitte & Touche LLP ("D&T") performed their audit of FPA's consolidated financial statements at December 31, 1996 and for the year then ended in accordance with generally accepted auditing standards ("GAAS"). Mr. Holder also expresses the opinion that FPA's unaudited consolidated financial statements at September 30, 1997 and for the nine months then ended were prepared in conformity with GAAP and that D&T had no responsibility for periods after the date of their 1996 audit opinion. Mr. Holder's Report did not change my opinion, nor does it directly discuss or refute the GAAP violations identified in my January 14, 2002 Report.

FPA's consolidated financial statements for the year ended December 31, 1996 and for the nine months ended September 30, 1997 did not disclose the Guaranteed Access Payment ("GAF") arrangement under which Foundation agreed to pay FPA $55 million over a thirty month period. The accounting for the alleged loss contracts and the payments for the shared risk, capitation levels and enrolled members from Foundation, was not disclosed. The lack of disclosure is a violation of GAAP in that disclosure is required. Accounting Principles Board ("APB") No. 30, paragraph 26 states, "*A material event or transaction that is unusual in nature or occurs infrequently but not both . . . The nature and financial effects of each event or transaction should be disclosed on the face of the income statement or, alternatively, in notes to the financial statements.*" Accordingly, no matter how you view the GAF payments and the contingent consideration, the consolidated financial statements do not comply with GAAP in that they failed to disclose the GAF arrangement and the contingent payments.

The following is a synopsis of Mr. Holder's observations and my rebuttal to his comments. The captions in this Report are taken from Mr. Holder's Report.

Summary of Opinions

"I did not become aware of material departures from GAAP in FPA's financial statements for the year ended December 31, 1996, nor did I become aware of any departures from GAAS in D&T's audit of those financial statements or in D&T's review of the 1997 quarterly financial information."

In arriving at the above findings, Mr. Holder failed to consider, or if he did consider, failed to discuss in his Report any of the allegations and related issues raised in the criminal indictment brought by the US Department of Justice in February 2002 against Mr. Lash, FPA's Chief Financial Officer ("CFO"). The indictment alleges, among other things, that Lash made materially false representations and omitted material facts concerning FPA's financial condition and operations in FPA's Forms 8-K, 10-K and 10-Q filed with the Security & Exchange Commission ("SEC") and intentionally reported fictitious earnings for FPA to the public during the relevant period. If Mr. Holder did consider the allegations, one would expect mention in his Report of the alleged false and misleading financial statements. There is no such discussion.

A. Role of the Auditor

"The auditor's responsibility for the financial statements he has audited is confined to the expression of his opinion on them."

Mr. Holder goes on to state in his Report that "*These factors are important if one is to fairly evaluate whether D&T met their professional responsibilities.*" While Mr. Holder correctly quotes from Statements on Auditing Standards ("AU") 110, he does not go far enough. Mr. Holder fails to address the issues underlying AU 316, "The Auditor's Responsibility to Detect and Report Errors and Irregularities" and AU 431, "Adequacy of Disclosure in Financial Statements.

> *AU 316 " . . . provides guidance on the independent auditor's responsibility for the detection of errors and irregularities in an audit of financial statements in accordance with generally accepted auditing standards. It describes factors that influence the auditor's ability to detect errors and irregularities and explains how the exercise of due care should give appropriate consideration to the possibility of errors or irregularities. It also provides guidance on the auditor's responsibility to communicate detected matters both within and outside the entity whose financial statements are under audit."*

> *AU 431 "The presentation of financial statements in conformity with generally accepted accounting principles includes adequate disclosure of material matters . . . An independent auditor considers whether a particular matter should be disclosed in light of the circumstances and facts of which he is aware at the time."*

These additional factors are equally important if one is to fairly evaluate whether D&T met their professional responsibilities. Based on evidence contained in their workpapers, D&T failed to:

- Use due care in the performance of their work;
- Maintain professional skepticism;
- Require FPA to make appropriate disclosures; and
- Communicate management judgments regarding the GAF arrangement to the audit committee.

Had D&T followed professional standards, the amount of FPA's revenue recognized in 1996 would have been reduced or eliminated, additional disclosures would have been made and the financial statements for the nine months ended September 30, 1997 would have been changed.

B. Financial Statements Presented in Conformity with GAAP

"Financial statement users can thereby use information contained in financial statements presented in conformity with GAAP with a degree of confidence that the information has been developed using principles that are widely disseminated and generally well understood."

If financial statements are presented in accordance with GAAP then there should be a degree of confidence that the information presented has been developed using principles that are widely disseminated. On the other hand, if financial statements are not presented in accordance with GAAP, then users cannot use the information contained in the financial statements to make meaningful observations and conclusions. Irrespective of the question as to whether or not GAF receipts should be treated as revenue, the absence of the appropriate disclosure regarding revenue recognition is a GAAP departure in and of

itself. GAAP requires that the revenue recognition methodology be disclosed. As I stated in my previous report, recognizing contingent payments as revenue upon receipt does not "enhance the comparability of financial reporting . . . ".

C. Financial Statement Audits: Overview and Context

"To assess whether a particular audit of a set of financial statements complied with professional standards, it is necessary to consider the audit as a whole."

The Nature of Financial Statement Audits in Accordance with GAAS

"Financial statement audits are designed to provide reasonable assurance that the financial statements that have been audited are not materially misstated."

Among other things, the purpose of an audit in accordance with GAAS is to determine if the financial statements under examination are free from material error. If material errors go undetected, such as recognition of inappropriate revenue, then it is axiomatic that there has been an audit failure.

1. Date of the Auditor's Report

"The auditor's report should be dated at the time that the audit process is complete even though the financial statements to which it relates may not be issued for some time. This is to communicate clearly to readers of the audit report that the

auditor has not applied audit procedures thereafter and that the auditor has not continued to identify events and transactions taking place after the date of the auditor's report that might require disclosure or recognition in the financial statements."

The above statement is taken from AU Section 530. However, GAAS requires additional procedures whenever an audit opinion is reissued by the auditor at a subsequent date, particularly in a registration statement filed with the SEC. In that event, the GAAS requirement is specified in AU Section 711 "Filings under Federal Statutes". Under that section, the auditor (D&T) is required to make a reasonable investigation (a subsequent events review) to determine that the financial statements that were originally reported on are still presented in conformity with GAAP. D&T issued their audit opinion with respect to the December 31, 1996 consolidated financial statements on March 21, 1997 and consented to have their opinion included in FPA's S-4 on February 9, 1998; the S-4 became effective on February 17, 1998. The closing of the business acquisition covered by the S-4 occurred on March 20, 1998, the date on which D&T completed their audit work covering 1997. D&T was responsible for their original opinion through February 17, 1998, the effective date of the S-4.

Opinions and Basis for Opinions

A. Accounting and Auditing Issues related to the Foundation Acquisitions Reported in FPA's December 31, 1996 Financial Statements

Mr. Holder expresses the opinion that *"the manner in which FPA accounts for and reported the 1996 acquisitions*

of certain Foundation entities, including the recognition of the GAF payments, complied with GAAP" and that the *"audit procedures performed and related conclusions reach* [sic] *by D&T . . . complied with GAAS"*.

Based on Mr. Holder's comments regarding the factual background and his analysis, his conclusion that the accounting and reporting of the GAF payments as revenue upon the receipt of cash complies with GAAP is contrary to the facts as he states them. In addition, since the GAF payments were material, appropriate disclosure was required. Said disclosure was not made.

1. Factual Background

> *"The sum of the GAF payments related to 1996 amounted to $15.250 million. In essence, the GAF payments were amounts to be paid by Foundation to FPA if FPA performed certain tasks appropriately and refrained from taking certain courses of action for a period of time following the consummation of the transactions . . .*
>
> *. . . In correspondence between the SEC and FPA, the SEC raised the issue of the GAF payments at the consummation of the business combination. FPA provided a description of the relevant provisions of the agreement and explained the rationale for accounting for the GAF in the manner FPA had selected. The SEC did not object to the position taken by FPA."*

Mr. Holder notes that $15.25 million of GAF payments by Foundation were made to FPA in 1996 and recognized as revenue. He fails to state, however, that the amounts paid by Foundation to FPA for FHMG California of $8.4375 million and TDMC, Arizona of $2.8125 were

received in December 1996, only days after the closing of the acquisition by FPA of these businesses. He also does not address the issue of the declining GAF quarterly payments related to FHMG and TDMC to be received by FPA through November 1, 1998. Assuming for the sake of argument that GAF payments should have been recorded as revenue, GAAP requires that revenue be spread equally over time or recorded in relationship to the costs incurred. This was not done.

Mr. Holder also states that *"The SEC did not object to the position taken by FPA."*

The letter to the SEC that was furnished to me does not state that FPA would record the GAF payments as revenue as it received the cash even though the payments are "front-ended" loaded (more cash with the first payment and lesser amounts as each payment was to be made) and the services to earn the GAF payments were to be rendered over time.

I have attached as Exhibit 1 a February 18, 2002 letter from Mr. Lynn E. Turner, former Chief Accountant to the SEC, to Mr. Philip Borowsky which explains the SEC Review and Comment Process as well as the limitations on the SEC Staff Review.

I have also attached as Exhibit 2 a letter from Steven M. Lash (CFO) to Sean Conlon of Banque Paribas, dated March 4, 1997 which explains the accounting treatment for the GAF.

The GAF payments represented a contingent refund of the purchase price and should have been accounted for in the same manner as APB No. 16 specifies in accounting for contingently issuable consideration in a business

combination. As FPA performed the services expected by Foundation, FPA would receive a "refund" of the amounts originally paid by FPA to Foundation. The amount paid by Foundation to FPA guaranteed that FPA would provide future services to Foundation members. In the final analysis, as GAF payments were received, the value of acquisition should have been reduced and not recognized as revenue.

2. Analysis

"FPA's realization of the potential GAF payments was dependent on FPA meeting certain obligations and commitments contained in the acquisition agreement. In my opinion, the duties accepted by FPA to operate facilities in a manner that meets certain minimum criteria were substantive."

"The measurement of earnings involves the accounting concept of matching revenues with the expenses that were incurred in generating those revenues. The performance of an enterprise is measured and reported in financial statements through this matching process . . .

. . . revenues are considered to have been earned when an entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues" (emphasis added) . . .

. . . D&T performed substantive audit work to gain an understanding of these transactions generally and the GAF payments in particular. Specifically, D&T discussed the transactions with management of both FPA and Foundation, read the contracts, tested first set of payments that related to the year ended December 31, 1996, and

considered the authoritative accounting literature . . . D&T concluded that it was reasonable to account for the GAF amounts as revenue because the earnings process for each of the payments was considered complete when evidenced by the receipt of a payment for the period in question . . .

. . . D&T viewed the potential GAF payments to be received as being earned as FPA conducted its operations and met its obligations under the agreements . . . FPA properly recognized revenue in the amount of each payment as Foundation made those payments and FPA earned the related revenue."

While Mr. Holder quotes from Statement of Financial Accounting Concepts ("FAC") No. 5, paragraph 83, he fails to address paragraph 84 of FAC No. 5 which states, *"If services are rendered or rights to use assets extend continuously over time . . . revenues may be recognized as earned as time passes."*

Mr. Holder also fails to reconcile the methodology used by FPA for recording the GAF receipts as revenue with the footnote disclosure regarding revenue recognition contained in FPA's 10-K for 1996 (Note 1) which states that:

"managed care capitation payments from Payors are paid monthly and are recognized as revenue during the period in which enrollees are entitled to receive services"

Finally, Mr. Holder fails to explain the "substantive" duties that FPA performed in December 1996 to warrant recognition of the entire amount of the GAF payment received in 1996. He also fails to explain how these substantive duties were different than the duties that FPA would perform in the normal course of its business.

Although FPA was entitled to receive cash from Foundation immediately after the closing of the acquisition in December 1996, Mr. Holder failed to establish that "matching" costs were incurred or that services were rendered to "earn" the revenue. The recognition of revenue by FPA upon the receipt of cash is improper because GAAP requires revenue to be recognized as earned either over time or on the basis of costs incurred.

> Mr. Holder also states "*D&T performed substantive audit work to gain an understanding of these transactions generally and the GAF payments in particular. Specifically, D&T discussed the transactions with management of both FPA and Foundation, read the contracts, tested first set of payments that related to the year ended December 31, 1996, and considered the authoritative accounting literature . . . D&T concluded that it was reasonable to account for the GAF amounts as revenue because the earnings process for each year of the payments was considered complete when evidenced by the receipt of a payment for the period in question . . .*
>
> *. . . D&T viewed the potential GAF payments to be received as being earned as FPA conducted its operations and met its obligations under the agreements . . . FPA properly recognized revenue in the amount of each payment as Foundation made those payments and FPA earned the related revenue.*"

There is no discussion in D&T's 1996 workpapers regarding the accounting for the GAF payments. The only mention of GAF accounting was contained in D&T's 1997 workpapers (FPA/DT 0229) attached as Exhibit 3.

Based on their 1997 analysis, D&T knew the following about the GAF payments:

- That the GAF payments arose in connection with FPA's acquisition of certain health care businesses from Foundation Health Services, Inc. (Foundation) and that the accounting for these payments would have a material effect on FPA's results of operations;
- That the GAF payments were to be received over time and that they were "front-end loaded" (payments were higher in the beginning and declining over time); and
- That Foundation became a significant shareholder of FPA as a result of the acquisitions.

D&T were also the auditors and consultants for Foundation and knew the "other side of the story", namely, that Foundation recognized the sale of certain of its operations and charged all of the costs, including the GAF obligations and guaranteed payments to the gain on the sale of the businesses in 1996, yet FPA was recording revenue as it received the cash payments.

However, in spite of the above, D&T did not require any disclosure of the accounting or the circumstances surrounding the GAF payments in FPA's footnotes. This is a violation of GAAS as explained previously.

It is unclear whether or not D&T consulted with other partners within the D&T organization as to the proper accounting and disclosures for the GAF payments. There was no reference to research of the accounting literature regarding the proper accounting for the GAF payments. GAAS (AU 339) provides that *"the information contained in working papers constitutes the principal record of the work that the auditor has done and the conclusions that he has reached concerning significant matters."*

D&T knew that it had a requirement *"to determine that certain matters related to the conduct of an audit are communicated to those who have responsibility for oversight of the financial reporting process. (AU 380)."* This requirement states, *"The auditor should determine that the audit committee is informed about the initial selection of and changes in significant accounting policies or their application. The auditor should also determine that the audit committee is informed about the methods used to account for significant unusual transactions and the effect of significant accounting policies in controversial or emerging issues . . . For example, significant accounting issues may exist in areas such as revenue recognition . . . "* D&T failed to provide FPA's audit committee with sufficient information about the GAF payments and the related accounting that FPA's management had selected. This is a GAAS violation.

B. Issues Related to FPA's September 30, 1997 Unaudited Interim Financial Statements

"Although D&T did not audit the FPA financial Statements for the nine-month period ended September 30, 1997 and did not issue a report on those financial statements, Mr. Stevens criticizes the accounting for certain transactions reported in those financial statements."

Mr. Holder's comments imply that D&T had no obligation to read these unaudited financial statements. However, D&T was associated with the unaudited financial statements contained in the registration statement filed with the SEC since D&T was named as an expert in accounting and auditing.

1. Background

"Those financial statements were clearly labeled as unaudited in the registration statement. D&T did review FPA's quarterly financial information, including that for the quarter ended September 30, 1997; however, no opinion was expressed or report issued by D& T with respect to any of that interim financial information . . .

. . . The registration statement does not purport to provide any assurance by D&T with respect to the unaudited interim financial statements . . .

. . . The financial statements for the period ended September 30, 1997 accounted for the GAF payments in a manner consistent with the preceding discussion and for the reasons I previously expressed, I believe that method of accounting was appropriate."

Despite Mr. Holder's view, the auditor is required to read the other information contained in the registration statement and consider whether the statements therein were true and there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading. D&T failed to require disclosure of the accounting for the GAF receipts and other contingent receipts.

Mr. Holder accepts the revenue recognition of the GAF payments on a cash basis as being in accord with GAAP based on his analysis for the year ended December 31, 1996. He does not comment on the effect of receiving payments in advance of services rendered, or on the reduced amount of the quarterly GAF payments received in 1997 as compared to December 1996.

There is no disclosure regarding the GAF payments in the registration statement or in the 10-Qs which are incorporated by reference. The recognition of revenue on a cash basis is a violation of GAAP in that revenues were not "matched with expenses". The lack of disclosure is also a GAAS violation.

2. The Loss Contracts: Accounting for Preacquisition Contingencies

"FPA recognized at the time of combinations that certain contractual obligations might result in losses to FPA. During 1997, losses of that nature were incurred . . . Mr. Stevens does not appear to recognize that $9 million of the amount he identifies represents preacquisition contingencies that are to be accounted for in accordance with the requirements of FAS No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises . . .

. . . . Finally, FAS No. 38 states: "After the end of the "allocation period" an adjustment that results from a preacquisition contingency . . . shall be included in the determination of net income in the period in which the adjustment is determined . . .

. . . Based on the information available to me, FPA accounted for those changes in the manner called for by FAS No. 38 and, therefore, the accounting was appropriate."

Mr. Holder considers the $9 million as a preacquisition contingency. He does not address the recording of $3.4 million of profit attributable to the $9 million which is material in and of itself. Apparently Mr. Holder believes that FPA is entitled to record a profit on these alleged

"loss" contracts. Mr. Holder also does not address the reasonableness of using a line of business analysis to calculate these losses. The line of business analysis is based on "Intergroup Products Only" and which attributed the losses to "commercial and senior care" lines, excluding individual lines. There is no indication that a separate contract existed which covered only commercial and senior care. In my opinion, these "lines of business" acquired from Foundation cannot be logically separated to make a provision for a loss under GAAP.

It is impossible to conclude that the accounting conforms to GAAP without consideration of the above issues.

3. Shared Risk, Capitation Levels, and Enrolled Members

"Mr. Stevens asserts that FPA should have accounted for the $23.7 million in " . . . guaranteed risk-share, capitation levels, and enrolled members" received in 1997 as a reduction in the purchase price of Foundation . . . Based on the evidence I have reviewed, I fail to see a reasonable basis for the conclusions Mr. Stevens reaches."

Although Mr. Holder states that he fails to see a reasonable basis for the conclusions that I reached, he does not address the question of APB No. 16 and/or FAS No. 38 as being applicable to these payments, why alleged contract losses should be calculated before the receipt of these payments, nor does he comment on the lack of disclosure of these payments.

Without considering these factors, one cannot determine whether or not the accounting is in conformity with GAAP.

In summary, Mr. Holder does not believe that the GAF payments and the other contingent payments represent an adjustment of the purchase price and that these payments are revenue in the period received.

III. Conclusion – The financial statements failed to comply with GAAP

After reading Mr. Holder's report and considering the effects of his comments, it is my opinion that FPA's consolidated financial statements at December 31, 1996 and September 30, 1997 failed to comply with GAAP. Even assuming that the GAF receipts were income on the date received, these financial statements were misleading. The financial statements lacked the appropriate disclosures about the accounting for the GAF receipts and the other contingent payments.

The facts do not support the recognition of revenue for the GAF payments. FPA recorded revenue based upon the receipt of cash in December 1996 (within days of acquiring the business from Foundation) even though the services to earn such revenues were to be provided at least through December 31, 1998. The future GAF payments became receivable only as the right to receive them was earned by FPA "performing its tasks in accordance with the agreement." FPA could not have possibly "earned" the amount of revenue reported in December 1996 and no evidence is presented which supports that FPA "matched" its expenses with the amount of GAF revenue reported in 1996.

Furthermore, as I stated in my original report, "*FPA was experiencing a severe liquidity crisis as evidenced by its newly undertaken programs to aggressively reduce costs and generate cash at the time the S-4 became effective on February 17, 1998, the S-4 failed to disclose this fact. The liquidity crisis resulted in FPA seeking bankruptcy protection approximately three months following the merger of Orange Coast Managed Care Services, Inc. and St. Joseph Hospital Corporation with FPA*".

Exhibit 1

Lynn E. Turner
13681 Fall Creek Circle
Broomfield, Colorado 80020

February 18, 2002

Mr. Philip Borowsky
One Market Plaza
Suite 2600
Steuart Tower
San Francisco, California 94105-1419

Re: Madden et. Al. v. Deloitte & Touche et. Al.

Dear Mr. Borowsky:

You have requested that I provide you with a letter describing the review and comment process of the Securities and Exchange Commission (SEC). I understand the letter will be used by an expert retained by or on behalf of the Plaintiffs in the above-mentioned case. This letter describes the SEC review and comment process and does not comment on the appropriateness or lack thereof of the accounting for any particular transaction.

Qualifications

I was appointed and served as Chief Accountant of the SEC from July 1998 to August 2001. The Chief Accountant is the principal and lead advisor to the Chairman and members of the SEC on all financial reporting and disclosure matters, including those involving public companies and their auditors. I was responsible for interpreting and implementing the applicable rules regulations of the SEC. I had responsibility for the oversight of the establishment of auditing and financial reporting standards in the U.S. and Internationally. I also was the SEC staff person responsible for initiating, drafting and proposing to the SEC, rules or changes in rules related to financial reporting and disclosure by public companies, as well as the audits of those companies' financial statements. I also had the responsibility of resolving differences of views between the SEC Staff, including the Staff of the Division of Corporation Finance, and a registrant and their auditor on a financial reporting or disclosure issue. From June 1989 to July 1991, I also served a two-year fellowship in the Office of the Chief Accountant of the SEC during which time I worked on many filings made by public companies.

I was Vice President and Chief Financial Officer of Symbios, Inc., a large international manufacturer of semiconductor and storage solution products from June 1990 to June 1998. In that capacity, I was a member of the executive management team and responsible for preparation of the annual and quarterly financial statements of the Company.

I was an audit partner of the international public accounting firm, Coopers & Lybrand (now PricewaterhouseCoopers) from 1991 to 1996. I also was a member of

the staff of Coopers & Lybrand from 1976 to 1989, in increasing roles of responsibilities. While I was at Coopers & Lybrand, I was an auditor on many public companies, including serving as an audit engagement partner. I was also an SEC reviewing partner, responsible for reviewing registration statements filed with the SEC and responding to SEC comment letters. I was also the partner in charge of the firm's High Technology audit practice in the United States. From 1983 to 1985, I was a member of the national Accounting and SEC technical office of Coopers & Lybrand, which developed the firm's policies and procedures, including those related to public companies.

In August 2001, I joined the faculty of the College of Business of Colorado State University as a professor of accounting and director of The Center for Quality Financial Reporting. I now serve on that faculty.

SEC Review and Comment Process

The Staff of the Division of Corporation Finance (Staff) perform the reviews of the filings of public companies registered with the SEC. This includes reviews of registration statements, proxies and annual and quarterly filings. The Staff reviews are performed to ensure there is full disclosure in accordance with the applicable rules and regulations of the SEC, including compliance with generally accepted accounting principles (GAAP). These reviews are not intended to make a determination of the merits of any particular security offering or registrant. In addition, due to budgetary and resource constraints, the Staff does not perform a review of all filings.

The Division of Corporation Finance is organized into 11 Assistant Director Offices. A registrant is assigned to

one of the eleven offices based on the issuer's primary Standard Industrial Identification Code (SIC). A team of accountant's, attorney's and financial analysts are used to review a filing when it is submitted.

Upon the submission by a registrant of a filing to the SEC, a determination is made by Staff as to what type of review of the filing will be made. This may include a full review of the filing, a deferral of a review of a filing if it has serous deficiencies that need to be corrected before a review can be performed, a full financial review in which the reviewer reviews the accounting and financial statement portions of the filing but not other portions, a monitor review where only a portion of the filing may be reviewed that may not include the financial statements, or the Staff may decide not to review the filing. If it is determined a filing will be subjected to a review, it is assigned to one of the Assistant Director Offices within the Division of Corporation Finance.

A staff accountant, financial analyst and attorney are assigned to review a filing. It typically takes the staff approximately thirty days to perform their initial review. Their comments are prepared and incorporated into a "comment letter" to the registrant. The comments may request revisions to be made to a filing if the Staff believes the registrant's accounting is not in accordance with GAAP or additional disclosures are necessary to comply with the full disclosure requirements of the SEC's rules and regulations. The comments may also request clarification of a disclosure that is unclear to the Staff or may request additional information if the Staff is uncertain about a particular disclosure. The comments are also subject to a review by a supervisor. Once the review of the comment letter is completed, it is issued to the registrant.

Once a registrant receives a comment letter from the Staff, they respond back in writing to the various comments with the assistance of their legal counsel, auditors and underwriters. The response letter may provide additional facts necessary for the Staff to fully understand the relevant disclosures, it may result in revisions being made in an amended filing with the SEC, or the registrant may take exception to the SEC Staff's comments and provide reasons supporting the original disclosures or position taken in the original filing by the registrant.

The Staff will review the response letter and make a determination as to whether the changes made by the registrant or the additional information it receives, including support for positions the registrant believes are correct are adequate. If the Staff believes further modifications to the filings are necessary, it will send another comment letter to the registrant. This process of comments and responses continues until the Staff believes, based on the information it has been provided, that the disclosures in the filing comply with the applicable SEC rules and regulations and generally accepted accounting principles.

Limitations on the SEC Staff Review

The SEC review process is based on the disclosures provided in the filings made with the SEC. It is the responsibility of the registrant to comply with all the applicable statues, rules and regulations. The Staff are not to be relied upon to identify deficiencies in a filing. The Staff do not perform an audit of the registration statements or other filings to determine if they are complete or factually correct. Instead, the Staff and investors rely upon the "gatekeepers" to the financial markets, such as the

independent auditors and securities legal counsel to ensure that full disclosure is made to investors. Accordingly, if the information submitted to the SEC Staff is incomplete or factually incorrect, an error or omission in the filing may very well go undetected by the Staff. For example, if a description of a particular transaction and its relevant facts are incomplete or misleading, the Staff may not identify that an error in disclosure or accounting has been made. Accordingly, the SEC does not "approve" a filing or the financial reporting therein. That is the responsibility of the registrant and their auditors. Instead, *based on the disclosures contained in a filing,* including any subsequent amendments, the SEC Staff will make a determination as to whether the filing should be declared "effective" in which case the securities offering may proceed.

This letter is prepared solely for use in this case, and cannot be used for any other purpose without the express permission of its author. My billing hourly rate for the preparation of this letter is $485.

Sincerely,

/s/ Lynn Turner
Lynn Turner

Exhibit 2

[FPA Medical Management Letterhead]

FPA Medical Management, Inc.
Leading the Way in Managed Care

3636 Nobel Drive
Suite 200
San Diego, California
Tel 619 453-1000
Fax 619 453-0951

March 4, 1997

Sean Conlon
c/o David Canavan
Banque Paribas
787 7th Ave., 32nd Floor
New York, NY 10019

Dear Sean,

I am enclosing the following information for your review.

1. An explanation of the accounting treatment for the GAF.
2. An analysis of the IBNR reserves in the various regions.
3. Comparison of budget by region to 1995 as well as the Nov '96 projection.
4. Covenant calculations with all "cushions" flowing through the formulas.

I look forward to speaking to you soon and resolving this promptly.

Very truly yours,

/s/ Steve (MH)

Steven M. Lash
Executive Vice President
Chief Financial Officer,
and Treasurer

SML/mh

Enclosures

cc: Pam Levy

DATE: 3/4/97
TO: Sean Conlon
FROM: Steven Lash
RE: 4th Quarter EBITDA

This memo will serve to outline our accounting approach and philosophy for the GAF payment and its effect on the covenant calculations.

The GAF payment was intended to provide FPA enough transition time to "turnaround" the Foundation Health Medical Groups acquired on December 1, 1996. The total payments to be received were $55 million over 10 quarters and were "front loaded" i.e. to provide a higher payment earlier since losses were going to be greater in the earlier quarters.

During the fall as the banks were reviewing the Foundation pro-formas, FPA invented a concept called GAF reserve which was simply a budgetary device to demonstrate that the GAF will be managed to ensure smooth earnings and that all the full effect of the GAF would not necessarily fall to the bottom line. FPA would allow only the amount necessary to normalize earnings. Any "excess GAF" would be preserved by increasing reserves in the regions. This is what we did in Q4. This becomes a smaller issue in '97, and in fact immaterial as a percentage of revenue in the last half of '97.

By allowing all these dollars to fall to net income and reporting this to street (EPS of 36¢) would have a dramatic, negative effect on the company that would virtually eliminate any hope of equity raising in the future, by moving the earnings bar to an unstarnable [sic] level going forward.

The way it works in the accounting world is that for other divisions of FPA (specifically the East Coast) IBNR estimates were raised, whereby the division's earnings are lowered for the quarter. Since FPA reports on a consolidated basis, earnings are managed approximately (we beat street expectations by 2¢ in Q4), and reserves are built up for future quarters. We did not set up a GAF reserve account since this is not appropriate accounting nor would it facilitate the management of the earnings stream.

SML/mh

Exhibit 3

[illegible initials] 2-20-98

FPA MEDICAL MANAGEMENT, INC.
MEMO RE: GUARANTEED ACCESS FUNDS
12/31/97

In November 1996, FPA completed the acquisition of the Thomas Davis Medical Center ("TDMC") and Foundation Heath Medical Group ("FHMG") from Foundation Health Systems, Inc. ("Foundation") for a combination of FPA common stock, debt, and cash (the "Foundation Transaction"). In connection with the Foundation Transaction (primarily the purchase of TDMC and FHMG, but to a lesser extent to IPA's (Florida and Arizona) acquired from Foundation in June 1996), an agreement was entered into between FPA Medical Management, Inc. ("FPA") and Foundation for the payment of guaranteed access funds ("GAF") by Foundation to FPA. According to the agreement, these GAF payments were being made in consideration of FPA fulfilling certain agreed upon operating requirements (doctor/patient ratios, keeping medical facilities open, acceptance of Foundation enrollees, etc.)

for TDMC and FHMG. These payments are to be received quarterly over a period of approximately 2 1/2 to 3 years and, according to the agreement, are earned as received. Accordingly, if FPA was to violate the GAF agreement they would not be entitled to receive future GAF payments, however, the GAF payments already received to that point would belong to FPA. It appears appropriate for FPA to recognize these GAF payments as revenues in the period earned based on the following:

– When FPA makes clinic acquisitions, they quickly implement an FPA operating model that often times includes restructuring activities such as hiring or firing of physicians, increasing physician patient loads, and closing facilities. In order to meet the requirements of the GAF agreement and earn the associated revenues, FPA will not be able to implement their FPA operating model in a timely manner. As FPA will be required to incur costs associated with meeting the GAF requirements (physician salaries and facility costs), in order to achieve an appropriate matching of revenues and expenses, it appears appropriate for FPA to recognize such GAF payments as revenues when earned.

– Based on our involvement with the Foundation Transaction and our discussions with Steve Lash, CFO, we noted that the GAF payment amounts did not have an effect on the purchase price in the Foundation Transaction. This is evidenced by the fact that we reviewed preliminary terms sheets for the foundation transactions before and after the creation of the GAF concept and noted no significant impact to the terms of the transactions. Additionally, per Steve Lash and discussions with various members of Foundation management, it appeared as if Foundation's motivation in negotiating the GAF arrangement was due to the significant impact any changes to the

operations of TDMC and FHMG would have on the operations of Foundation because of the significance of Foundation enrollees that utilized the TDMC and the FHMG. Accordingly, Foundation and FPA negotiated this arrangement at arms-length and, accordingly, such payments appear appropriately recorded as revenues when earned by FPA.

[Certificate of Service omitted in printing.]

[Exhibits Q, R, S, T, U, V, W, and X omitted in printing.]

APPENDIX J

(DISTRICT COURT'S EVIDENCE IN SUPPORT OF MOTION FOR RECONSIDERATION OF INTERLOCUTORY SUMMARY JUDGMENT)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. 99-CV-1516 W (AJB)

CHARLES T. MADDEN; *et al.*, Plaintiffs,

v.

DELOITTE & TOUCHE LLP; *et al.*, Defendants.

NAVIN P. AMIN; *et al.*, Plaintiffs,

v.

DELOITTE & TOUCHE, LLP; *et al.*, Defendants.

[Filed February 7, 2003]

[Index of Exhibits omitted in printing.]

EXHIBIT 1

CHARLES T. MADDEN; *et al.*, Plaintiffs,

v.

DELOITTE & TOUCHE LLP; *et al.*, Defendants.

NAVIN P. AMIN; *et al.*, Plaintiffs,

v.

DELOITTE & TOUCHE, LLP; *et al.*, Defendants.

I, Richard G. Stevens, declare as follows:

1. I am a Certified Public Accountant, duly licensed to practice professionally in the State of California, and the Managing Director of Hunter Stevens LLC. I have previously prepared two reports of my findings for this Court, copies of which are attached hereto as Exhibits 1 and 2. I make this declaration to supplement my previous reports and deposition testimony based on newly discovered evidence presented to me subsequent to November 14, 2002. My expertise in the matters that are in issue in this litigation is set forth in my resume, which is part of Exhibit 1, at page 10.

2. The Plaintiffs in this action retained me to provide expert opinions in accounting and auditing matters and related issues concerning the work performed by Deloitte & Touche LLP ("Deloitte") with respect to the merger between FPA Medical Management, Inc. ("FPA") and Plaintiffs' former corporations, SJMC and OCMCS, as well as FPA's publicly filed financial statements that Deloitte audited and reviewed.

3. Exhibits 3 and 4 are true copies of documents identified respectively as the "*Wells* Submission" of certain former FPA executives and a "Credit Comment" prepared by BankBoston, N.A., a major lender to FPA.

4. The *Wells* Submission and the Credit Comment were not previously available to me as part of the discovery

in this action. I am informed and believe that Exhibits 3 and 4 were produced to the United States Attorney for the Southern District of California and presented to the Grand Jury that indicted Defendant Steven M. Lash, former Chief Financial Officer of FPA Medical Management Inc. (FPA) in *United States v. Lash,* No. 02cr0366-H. I am further informed that by order of this Court in *Madden v. United States,* No. 02mc0259-W, Plaintiffs obtained these documents as part of those grand jury materials in November 2002.

5. In late November 1997, Deloitte's auditing team prepared and reviewed a "Risk Factors Worksheet" utilizing FPA's internal unpublished financial information. A true and complete copy of the Risk Factors Worksheet is attached as Exhibit 5. In that Risk Factors Worksheet, Deloitte determined that FPA was "in danger of bankruptcy." In deposition testimony which I have reviewed, Deloitte's auditors David Hamann and John Hartley testified that they had done no analysis until March 1998 to confirm FPA's viability as a "going concern." However, Exhibit 3, the *Wells* Submission, evidences that Deloitte in fact had extensively reviewed FPA's financial records and its financial condition with FPA's Chief Financial Officer, Defendant Steven M. Lash, by the end of December 1997.

6. FPA's filing of the S-4 Registration Statement in mid-February 1998 required Deloitte to reissue its audit opinion on FPA's 1996 consolidated financial statements. Generally Accepted Auditing Standards (AU Sections 560 and 711) required Deloitte to perform certain procedures to determine whether any subsequent event had occurred after the issuance of Deloitte's original audit opinion that was significant to the 1996 consolidated financial statements.

7. The *Wells* Submission (Exhibit 3) and the Risk Factors Worksheet (Exhibit 5) together evidence that Deloitte performed enough work by December 1997 to determine that substantial doubt existed about FPA's ability to continue as a "going concern" for a reasonable period of time. Procedures mandated by Statements on Auditing Standards ("SAS") Nos. 59 ("The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern"), 64 ("Omnibus Statement on Auditing Standards – 1990"), and 77 ("Amendments to Statements on Auditing Standards No. 22, Planning and Supervision, No. 59, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, and No. 62, Special Reports") require an auditor to:

- Obtain information about management's plans to mitigate the problem,
- Assess the likelihood of effective implementation of the plans; and
- Identify those elements that are especially significant to mitigating the going concern problem and test management's key assumptions.

8. Deloitte's own accounting and auditing expert (Mr. William Holder) testified that: "However, once information comes to the attention of the auditor that indicates there may be questions about the ability of the entity to continue in existence, then the auditor is indeed charged with exploring those particular issues, and that process can be rather extensive and involved . . . ." (Holder Deposition, at 100:7-12.)

9. Deloitte knew or should have known that Section 11 of the Securities Act of 1933 imposes civil liability for material misstatements or omissions in registration

statements on "every accountant . . . who has with his consent been named as having prepared or certified any part of the registration statement, or has having prepared or certified any report or valuation which is used in connection with the registration statement." In *Ahern v. Gaussoin,* 611 F.Supp. 1482-83 (D.Or. 1985) the Court stated, "We assume that generally accepted accounting standards do not provide protection from liability when the accountant 'fails to reveal material facts which he knows or which, but for a deliberate refusal to become informed, he should have known' should be revealed." (Quoting *Admiralty Fund v. Hugh Johnson & Co.,* 677 F.2d 1301, 1313 n.15 (9th Cir. 1982).)

10. Generally Accepted Accounting Principles require disclosure of certain risks and uncertainties that could significantly affect the amounts reported on the financial statements in the near term or the near term functioning of the reporting entity. (Statement of Position No. 94-6, Accounting Standards Executive Committee, American Institute of Certified Public Accountants.)

11. Under SEC regulations, publicly held business enterprises must describe, among other things, "any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way" and "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material unfavorable impact on the enterprise." (Reg. S-K, Item 303(a)(1) and (3)(ii).)

12. Although Deloitte noted in November 1997 that FPA was "in danger of bankruptcy," and as is evident by

the *Wells* Submission Deloitte had performed enough work to determine that substantial doubt existed about FPA's ability to continue as a "going concern" for a reasonable period of time, Deloitte failed to make the appropriate disclosures regarding these risks as mandated by Generally Accepted Auditing Standards and SEC regulations in Deloitte's February 1998 consent included in the S-4 Registration Statement.

13. If FPA and Deloitte had made the appropriate disclosures, FPA's stock price would have dropped in a similar fashion to what occurred in May 1998 when FPA announced its proposed $200 million write-down. As evident by Exhibit 3, within two days of that disclosure, the stock price of FPA dropped 75%. The disclosures would have also called into question FPA's ability to realize certain of its assets, including approximately $100 million of the goodwill recorded when FPA acquired certain operating segments from Foundation Health in 1996. That goodwill was included in the 1996 consolidated financial statements audited by Deloitte and incorporated by reference in the February 1998 S-4 Registration Statement. As evident by Exhibit 4, the proposed write-down of $200 million was a major surprise to the market and to FPA's principal lender, BankBoston, N.A.

14. Generally Accepted Accounting Principles require an adjustment or write-off of the carrying amount of an asset that will not be recoverable. A current period operating loss combined with a history of operating losses relating to the business units acquired from Foundation Health Care would demonstrate that FPA would not be able to recover most, if any, of the $100 million of goodwill referred to above. But for the Guaranteed Access Fund Payments ("GAF") recorded as revenue and approved by

Deloitte, the operations of the business units acquired from Foundation Health Care would have reported continuing operating losses.

15. Because Deloitte chose to accept the treatment of the $16 million GAF payments as revenue when the monies were received in 1996, FPA's loss from operations during the second half of 1996 was understated by the same amount – $16 million. By accepting this cash basis revenue policy, Deloitte allowed an additional $25 million in GAF payments to be recognized as revenue during the nine months ended September 30, 1997, resulting in FPA's loss from operations for that period to be understated by the same amount – $25 million. As or more important, as more fully discussed in my prior reports, Exhibits 1 and 2, FPA's failure to properly account for GAF payments in 1996 caused earnings to be overstated by 150%. The retrospective analysis that BankBoston, N.A., performed well after it had agreed to be a major lender of FPA established FPA's treatment of GAF was materially misleading. This analysis is set forth in Exhibit 4.

16. In my opinion and as Deloitte conceded for purposes of its motion for Summary Judgment, Deloitte should not have permitted FPA to recognize the GAF payments as revenue. By any measurement standard including Deloitte's, FPA's reported loss from operations during the six months ended December 31, 1996 and the nine months ended September 30, 1997 were materially understated by over $16 million and $25 million, respectively. This is also obvious by the analysis of FPA's major bank lender as set forth in Exhibit 4.

17. Although the marketplace knew some aspects of the accounting treatment of the GAF paid by Foundation

to FPA, neither Deloitte nor FPA disclosed the effect of the GAF payments on FPA's reported earnings or the danger of bankruptcy. Recording fictitious earnings allowed FPA to avoid an adjustment or complete write down of the goodwill recorded in 1996 when FPA acquired certain operations from Foundation Health until May 1998, when FPA acknowledged that it intended to write down about $125 million in goodwill, which FPA's Chief Executive Officer Stephen J. Dresnick admitted was at least 75% attributable to the Foundation transactions. This is all the more evident by Exhibits 3 and 4 which describes the price of FPA stock dropped by 75% within 2 days of May 15, 1998 when it was disclosed that FPA was planning to write down $200 million including $125 million in goodwill impairment.

18. The magnitude of FPA's potential bankruptcy, the material overstatement of earnings and the potential non-recoverability of over $100 million in goodwill represented an omission of material facts known to Deloitte (as referenced in Exhibit 3) at the time Deloitte signed its consent in mid-February 1998. The disclosure of those material facts would likely have changed or influenced the judgment of a prudent person relying on the information, particularly the Plaintiffs who were in the midst of selling their medical corporations to FPA in exchange for FPA's stock, and would have deterred them from engaging in the merger transaction.

19. The forgoing is within my personal knowledge and if called to testify, I would testify truthfully and competently thereto.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Dated: January 17, 2003

/s/ Richard G. Stevens
By: RICHARD G. STEVENS

[Exhibits 1 and 2 omitted in printing; see pages 179a-202a of this Appendix.]

STEVENS DECLARATION EXHIBIT 3

[Only portions of pages 1, 4, 11, 16, and 17 included in printing.]

IN RE FPA MEDICAL MANAGEMENT, INC.
LA-956
WELLS SUBMISSION
ON
BEHALF OF
DR. STEPHEN DRESNICK, JACK GREENMAN,
STEVEN LASH, JAMES LEBOVITZ AND MICHAEL MORRIS

* * *

This Wells Submission is made on behalf of Dr. Stephen Dresnick, and Messrs. Jack Greenman, Steven Lash, James Lebovitz, and Michael Morris (sometimes referred to collectively as the "Individuals") in response to notification by the staff of the Division of Enforcement ("the Staff") that it may recommend enforcement action in connection with various financial reporting and related MD&A disclosures by FPA Medical Management, Inc.

("FPA") during the period from the third quarter of 1997 to the first quarter of 1998.

* * *

FPA made sure that its auditors, Deloitte & Touche, reviewed or agreed with the accounting treatment for virtually all of the accounting issues raised here. Deloitte & Touche performed timely reviews of FPA's quarterly financial statements through March 31, 1998 and audited FPA's year end financial statements for 1996 and 1997.[5] Deloitte & Touche also provided ongoing and continuous advice pertaining to merger accounting and other issues and reviewed FPA's quarterly evaluation of its IBNR reserves. At the conclusion of the year-end 1997 audit, Deloitte & Touche provided an unqualified opinion with respect to FPA's financial statements. They reaffirmed this opinion to FPA's Audit Committee. At FPA's June 1, 1998 shareholders meeting, Deloitte & Touche representatives reiterated that conclusion to the FPA Shareholders in attendance.

* * *

Moreover, Deloitte & Touche reviewed the accounting treatment of the GAF payments and never suggested that they should be disclosed as a separate item in FPA's financial statements, in the notes to the financial statements or in FPA's periodic SEC filings (which Deloitte & Touche reviewed). Indeed, on June 5, 1997, Deloitte & Touche addressed the Board's questions regarding the

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[5] The year end 1997 audit identified as "key audit areas" many of the issues raised by the Staff, including IBNR, goodwill, acquisitions and shared risk payments. *See* Deloitte & Touche Presentation to the Audit Committee, December 18, 1997 (Tab 5).

accounting treatment of the GAF payments. *See* Tab 12, 13.

* * *

All the evidence shows that the restructuring reserves were properly set. At the end of 1997, Deloitte & Touche looked at all of FPA's acquisitions and the accounting for all acquisition related transactions, including restructuring charges. Deloitte & Touche did not question any restructuring reserves. FPA followed the same procedure for setting the reserves for Avanti and Orange Coast as it had for all of the past acquisitions that Deloitte & Touche reviewed and approved.

* * *

STEVENS DECLARATION EXHIBIT 4

CREDIT COMMENT

FPA MEDICAL MANAGEMENT, INC.
San Diego, CA

Date: June 24, 1998
CRR: 8
Page: 1
Author(s): FGFama
/s/ FGF

cc: KFMalone, CCWoodard, AWeinstock, PJLazenby, MESchneider

We began our relationship with FPA in July 1997 when we closed our $15MM commitment to the $275MM ($175MM Revolver and $100MM Term Loan) Lehman arranged package of facilities. We were named Administrative Agent because Lehman is not equipped to perform that function. We viewed our participation in the transaction as

an opportunity to learn more about the physician practice management business by banking one of the top three players. We were able to quickly establish ourselves, with the company and the bank group, as the leader of the credit. As part of our initial due diligence we performed checkings with large payors (Pacificare, Aetna and Foundation Health), equity analysts, and private equity investors experienced with the physician practice management industry.

In late October the company requested a waiver to allow three acquisitions for primarily stock-for-stock mergers valued at $82MM, $78MM in stock and $4MM in cash. The company's acquisition basket provided for an aggregate of $50MM in Permitted Acquisitions for the period from Closing (6/30/97) through 12/31/97. At that point the company had completed three acquisitions for a total of $48.8MM, composed of $28.3MM in stock, $16.4MM in cash and debt and $4.1MM in other consideration. In addition to these acquisitions the bank group had consented to the Health Partners acquisition for $185MM in stock. We consented to the three additional acquisitions based on the fact that the total cash and debt portion of the acquisitions made and to be made was $20.4MM with the remaining $295MM in acquisition consideration in the form of FPA stock. In other words, the company was using equity to increase the collateral pool. While the three proposed acquisitions generated negative EBITDA of $2.2MM in 1997 the company expected that, through a combination of $6.5MM in cost savings and $9MM in increased business and synergies under the FPA network, they would generate $13.3MM in EBITDA in 1998. FPA had EBITDA for the three and nine months ended 9/30/97 of $26MM and $64MM respectively. Senior

debt to EBITDA was 2.39x and total debt to EBITDA was 3.33x. EBIT to interest was 3.20x. The company had $28.5MM available on its revolver when we received approval on 11/18/97.

On November 5, 1997 a bank meeting was held in San Diego. The purpose of the meeting was to update the bank group on the company's performance and to allow the company to review the three proposed acquisitions for which it requested consent. The night before the meeting we had dinner with management where they requested us to consider an increase to the Revolver. The company had planned to raise equity during the fourth quarter, however, its stock price had declined from the mid $30s to the mid $20s along with the market decline in late October and the well publicized problems at Oxford. Management felt it would be best to wait until the first quarter to raise the equity when they expected a lot of the industry noise to die down. The company's pipeline for acquisitions was full and it wanted to continue to take advantage of opportunities to acquire practices. We wanted to do additional due diligence to be sure that we understood why the company had borrowed more than anticipated on the revolver and why there was additional need if the acquisitions were made primarily with stock. For that reason we handled the request for consent of the three additional acquisitions and the increase as two separate amendment/waivers. We also wanted to review the proposed increase with Syndications to determine if it would be better to restructure the facility. We expressed to the company our concern that the Lehman structured deal was not ideal and that the Bank Group was not supportive of a growth by acquisition strategy using bank debt. Syndications was concerned about going to market with a

restructured deal because of all of the noise surrounding the industry and the fact that the original Lehman syndication had failed six months earlier.

During the months of November and December we performed extensive due diligence in order to understand why the company's borrowings were substantially above expectations. During the month of December liquidity began to get very tight because while most of the purchase price of acquisitions had been in the form of stock, cash had been spent on post-closing items, in particular, paying down claims and other payables at acquired operations and restructuring charges associated with reducing the cost structure of the acquired practice (severance, lease termination, etc.). Steve Lash, CFO, acknowledged in a letter to the bank group that the acquisitions had gotten ahead of the company's financings and promised that the company would go to the market early in the first quarter to raise some form of junior capital. We also performed due diligence in order to understand some of the movements in the working capital accounts during the third quarter. The purpose of our due diligence was to answer four major questions:

(1) What caused the increase in accounts receivable?

(2) What caused the decrease in Claims Payable including IBNR?

(3) What caused the $58MM (as of that date) increase in borrowings, particularly in light of the fact that acquisitions were made primarily with stock? Were existing operations cash flow positive?

(4) Was the company successfully integrating acquisitions?

To perform our due diligence we reviewed the following:

An analysis of the changes in accounts receivable by quarter broken down by Foundation, California Region, Sterling and all other regions.

Consolidating financial statements for the first three quarters of 1997 for Foundation, California Region, Sterling and all other regions.

Actual versus budget analysis for Foundation and Sterling. Most other acquisitions had been consolidated into FPA's existing operations, making it impossible (according to management) to provide comparable analysis for other acquisitions.

Schedules of the restructuring charges for AHI and HealthCap (the two largest restructuring charges) detailing the break down of the charge, what had been expended to date and what remained to be expended. We also reviewed a schedule of cash expenditures for acquisitions made during the first three quarters and what was planned to be spent during the fourth quarter. The schedule detailed the restructuring charges and the working capital investment for each acquisition made during the period.

Chuck Woodard had a conversation with the company's audit firm, Deloitte & Touche to discuss the methodology used to calculate IBNR and the appropriateness of the current reserve, the quality of the financial staff, and the adequacy of the company's information systems.

A cash flow schedule accounting for advances on the credit facility for the months of October, November and December. The schedule demonstrated that the advances were being used to fund the cash portion of acquisitions, as described below. We also reviewed a cash flow schedule for the month of January which demonstrated that absent any new acquisitions the company would pay down $10.5MM on the credit facility.

Based on our analysis we determined that:

(1) The increase in accounts receivable was partly caused by the bookkeeping associated with a global capitation contract in the northeast. The agreement was entered into three years earlier when global cap was a new arrangement and FPA was a much smaller company with very little negotiating leverage. FPA agreed to allow the payor to hold back part of the revenue to pay third party claims on behalf of the company. FPA books a receivable to recognize the revenue and a corresponding IBNR liability to book the expense. The payor then reports the claims paid on FPA's behalf, however, if the report is not issued prior to quarter end FPA cannot relieve the AR and IBNR accounts and the balance sheet is inflated. The payor did issue a report to FPA after quarter end which indicated that $8.9MM in claims had been paid on its behalf during the third quarter.

We also discussed shared risk receivables which accounted for part of the increase in receivables. The shared risk pool represents the upside/downside hospital bonus pool under a professional cap arrangement. The pools are settled in the second or third quarter of the year

following the year in which the receivable was accrued. This receivable represented only 2-3% of the total receivables and the company stated that as more arrangements are converted to global cap there would be less shared risk pools. Finally, growth in Nevada membership where the capitation revenues are received in arrears (typically 60 to 90 days) caused part of the increase.

(2) FPA uses lag studies, consistent with industry practice, to determine the appropriate level of IBNR. The company's auditor, Deloitte & Touche, reviews the IBNR each quarter as part of their quarterly review and audits the reserve at the end of each year. We had a conversation with the company's auditor to confirm that FPA was calculating its level of IBNR appropriately. We determined that the decline in IBNR was driven by two main factors. First, the company paid down significant levels of claims assumed through several acquisitions which were accounted for as poolings. In a pooling transaction the company must restate its financial statements to reflect the acquired company, as if the company owned it at the beginning of the reporting period. Two large acquisitions in particular, AHI and HealthCap, were very bad at estimating the appropriate level of IBNR. This led to a ballooning of FPA's IBNR account as shown on restated historical statements and actual statements at closing, as FPA inherited the inflated IBNR accounts. While operated by FPA it was believed that the medical loss ratios at the acquired companies were brought under control and the IBNR accounts were reduced. This analysis was consistent with FPA's investment in working capital to pay down claims as illustrated in the review of cash flow below. The second factor

leading to a decline in IBNR is the capitation of specialists. If a specialist is capitated there will not be a claim generated because the doctor has already been compensated by the capitation payment. The percentage of specialists under capitation increased from 22% at the end of the first quarter to 29% at the end of the third quarter. Consistent with the increase a review of the company's expenses illustrates that the expense for capitated specialists as a percent of revenue had steadily increased for all lines of business.

(3) Although at the time of our review, the cash purchase price for acquisitions made and to be made had been only $14.5M, the company had spent and expected to spend a significant amount of cash on closing costs, restructuring charges and working capital (primarily paying down claims at acquired companies). We reviewed the detail of these cash expenditures which are summarized below:

(000s)	Closing Date	Acquisition	Restructuring, Closing Costs and Working Capital	Total
AHI	3/17/97	$0	$69,000	$69,000
HealthCap	6/30/97	$0	$12,800	$12,800
HealthPartners	10/13/97	$0	$12,000	$12,000
EMC	9/2/97	$8,000	$12,000	$20,000
Axminster	9/30/97	$2,500	$2,000	$4,500
Carolina	10/1/97	$0	$5,000	$5,000
Cornerstone	12/1/97	$0	$2,000	$2,000
PQC	12/97	$0	$2,000	$2,000

Avanti	1/1/98	$4,000	$5,000	$9,000
Meridian	IQ98	$0	$7,000	$7,000
Total		$14,500	$128,800	$143,300

From December 31, 1996 to December 15, 1997 the company had increased bank borrowings by approximately $65MM while completing approximately $120MM of the above cash expenditures. This means that the company was able to generate enough cash flow to fund approximately $55MM of the above expenditures plus fund its existing operations and the ongoing needs of acquired operations. The company had approximately $25MM in availability on its revolver and roughly $23MM in additional expected cash expenditures for the most recently made acquisitions and acquisitions expected to close within the next few months. The proposed increase to the revolver was intended to provide liquidity to ongoing operations and would fund the cash requirements of additional acquisitions. Management said it would raise junior capital during the first quarter to fund ongoing acquisition plans.

(4) The company made a significant number of acquisitions and, as illustrated by the chart above, invested a significant amount of cash to improve operations at acquired companies. A review of the Foundation Health business, acquired in November 1996, illustrated that the company had been very successful at improving operations. The financial statements presented to us indicated that the EBITDA margin, medical loss ratio, and SG&A on a dollar basis and on a SG&A to revenue basis all improved significantly under FPA's management. The results indicated that Foundation was well ahead of budget, consistent with what management had been telling us and

the market. Most other acquisitions had been consolidated into FPA's existing operations, making a comparable analysis of other acquisitions impossible according to management. However, the company consistently experienced declining or level medical loss ratios and SG&A to revenue ratios, confirming management's statements that those acquisitions had been successfully integrated.

Steve Lash, CFO, stated in December that there was not a liquidity problem and that the base business was strongly cash flow positive. He stated that if the bank group did not approve the increase to the facility the company would be forced to stop making acquisitions. On December 31, 1997 we received consent of 100% of the bank group to allow a $40MM increase to the Revolver. BKB took a $20MM share of the increase to bring our agent's share of the facility up to $35MM (11%). The total equity market cap of the company was $1 billion.

On December 10, 1997 the company issued a press release and held a conference call to discuss its exposure to Oxford and to give a full presentation of the company and the successful execution of its strategy to the investment community. During the presentation Seth Flam, CEO, said "the thing that I'm most proud of is we've managed the medical loss ratio to exceed expectations. That is the core focus of the company. That is what we do best. We are the outsource agent for medical loss ratio. As Steve will show you, quarter over quarter in our base business we have improved medical loss ratio. This is the core competency that not only HMOs are looking for but society is looking for to cure the ills in the health services industry." Our consultants now tell us that the medical loss ratio was rarely below 80% versus the 70 to 72% reported by the company, a shortfall in EBITDA of $80MM

to $110MM on the reported run rate of $130MM. Regarding its relationship with Oxford, Chris Berg, President of the Northeast division said that Health Partners paid a significant number of its own claims. However, we were told by Mike Morris on 5/27/98 that Oxford holds back up to 75% of the revenue from Health Partners to pay claims on its behalf, directly contradicting what we were told in December. Berg also said, that in the instances were [sic] Oxford does hold back revenue to pay claims on its behalf they receive claims data on a regular basis. However, a large part of the increase in receivables in the first quarter of 1998 relates to Oxford's inability to provide Claims data. As of 5/27/98 Health Partners was still attempting to settle the revenue hold back from the six months ended June 30, 1997.

On 1/15/98 BKB made a proposal to lead a $100MM to $150MM high yield offering and a proposal to refinance the bank facility. In the weeks following our presentation we had several conversations with Steve Lash regarding the proposal. In February 1998 the company hired a new Treasurer, Doug Kerner, who previously was Treasurer for Total Petroleum, North America before it was sold by its French parent. In early March we went to California to meet Doug and to meet with Steve Lash. At that meeting Steve informed us that the company had delayed the high yield because it was considering a leveraged recap and was expecting proposals from TPG, Thomas H. Lee and Apollo the following week.

On 3/6/98 the company issued a press release reporting results for the fourth quarter. The company did not issue a balance sheet or cash flow statement with the release. The company reported EBITDA of $33MM for the quarter, which was in line with our expectations, but due

to the pooling of Health Partners, which closed on 10/13/97, EBITDA for the year was $83MM, $14MM below what we expected, but understandable given the pooling of historical losses at Health Partners. During the analyst conference call the company stated that the Foundation clinics continued to track to plan although enrollment would be a challenge because Foundation was losing enrollment to Kaiser.

In mid-March Steve called to inquire about our interest in providing a bridge loan to the high yield or the recap. We responded that we would need to know which way they were going and what the transaction looked like. We gave some indicative terms that Steve felt were a little high and he stated that he had better offers from some of the investment banks.

On 3/23/98 we spoke with Steve and Doug again to get an update on the junior capital raising. Steve stated that if a recap proposal was submitted it would be reviewed at the board meeting the next day. He also planned to ask for authorization to proceed with a $100MM to $125MM high yield offering.

On 3/24/98 we contacted the company because we were concerned about liquidity and cash flow. Revolver availability was at $27.5MM, and there would be a need to finance recent acquisitions that had been announced. Doug indicated that the company had always paid its payables far too quickly and that he was hired to focus on cash management. He was in the process of slowing down payables to an appropriate level to generate some cash and manage working capital. He planned to pay down the revolver by $18MM by the end of March, giving the company $43MM in availability. He also delivered a monthly

cash flow statement, at our request, which indicated that the company would have $30MM in availability at the end of June. Total region and corporate cash flow was negative as the company paid down claims at acquired companies and paid out cash for acquisitions.

The company announced on 3/26/98 that CEO Seth Flam was stepping down to pursue other interests and CFO, Steve Lash, was stepping down as CFO, but would remain as Executive Vice President in charge of Information Systems, M&A, Human Resources and National Payor Agreements. Dr. Stephen Dresnick, the largest shareholder of the company, with a little over 4%, was named President and CEO effective immediately. Dr. Dresnick had served as Vice Chairman since October 1996 when the publicly-traded company (Sterling Healthcare Group) he founded was acquired by FPA. Doug Kerner, the new treasurer was named Acting CFO. Jack Greenman, Executive Vice President and CFO of Sterling Healthcare, became actively involved in all financial matters.

We generally viewed the management change as positive because the new management team planned to slow down the pace of acquisitions. On 3/27/98 we spoke with Doug Kerner who explained that the management change was the result of two factions on the board, one wanting to continue the acquisition plan and the other wanting to stop acquisitions and focus on internal operations. He also told us that a recap proposal was received from Thomas Lee and Apollo but was rejected because the price was inadequate (Smith Barney later stated that it was at a price of $18 to $19 per share).

On 4/2/98 we visited Dr. Dresnick and Jack Greenman in Miami. They confirmed that the company would begin

to focus more on internal operations and deleveraging the balance sheet and planned to slow down the aggressive acquisition pace. Any new acquisitions would be strategically important and must contribute positive EBITDA from day one. The company would no longer look at turnaround type opportunities which had led to the large investments in working capital to pay down claims. They both remained very positive on the industry and the company's strategy. We were very impressed with Dr. Dresnick and Jack, particularly Jack's conservative approach to managing Sterling's cash flow and other financial matters. Our meeting confirmed our positive opinion of this management change.

On April 14 the first organizational meeting for the high yield offering was held in New York. The underwriters included, Lehman Brothers as the lead, CIBC Oppenheimer, Merrill Lynch, Wasserstein Perella and BancBoston. At that point the schedule was to close on the high yield on June 8. On April 14 we met with the company after their presentation at the Merrill Lynch Health Care Conference. During their presentation management refused to answer any analyst questions regarding the financials or its capital raising efforts because they wanted to wait until they had an opportunity to review all of the operations. They stated that they would not be issuing the first quarter results or giving financial guidance until May 15. The company had $28MM in availability on April 14. This level of availability was consistent with the cash flow statement delivered at the end of March which indicated availability at the end of April of $30.8MM and availability at the end of June of $29.8MM.

On 4/22/98 the first due diligence meeting for the high yield was held in San Diego. At that meeting the company

delivered a cash flow statement by region for 1997 which indicated that while the company generated positive EBITDA, net cash flow was negative at all but the California and Southwest regions. The negative cash flow was caused by cash paid for restructuring charges and investment in working capital. The company stated that the investment in working capital was caused by: (i) hold back of revenue by HMOs to pay claims on the company's behalf (a situation not previously discussed with or disclosed to BKB despite repeated discussions regarding movements in the A/R account); and (ii) Sterling Medicare receivables, which were being delayed industry wide because of a change in the way Medicare reimbursed. New management stated that this was the first time that such a cash flow analysis was performed by the company. The company also informed the underwriters that it was in discussions with Foundation to renegotiate its contract. A declining enrollment coupled with the phasing out of GAF payments meant that the Foundation clinics (located in Sacramento and Arizona) would begin losing money in 1998 (for the past year old management had been saying that the clinics were ahead of budget and the budget to actual analysis we reviewed confirmed this). The company had begun active negotiations to fix the situation. They had also begun negotiations with Pacificare regarding the Nevada contract which was losing money. On 4/22/98 there was $24MM in availability.

On 4/30/98 there was $14MM in availability.

On 5/6/98 ($6MM in availability) Doug Kerner called to discuss the preliminary first quarter results and the possible default of the Senior Debt Ratio. He requested a waiver in advance of the May 15 earnings announcement. Doug indicated that EBITDA for the quarter would be

between $13MM and $21MM depending on the finalization of negotiations with Foundation and Pacificare. The company at that time believed that the true run rate EBITDA of the company was $20MM per quarter vs. $33MM reported for the fourth quarter of 1997 (as noted above our consultants now believe that quarterly EBITDA was probably substantially lower). The major cause for the difference was the reversal of reserves taken in previous quarters which were included as recurring income. This aggressive accounting inflated fourth quarter EBITDA by $10MM to $13MM. He also indicated that the company had been cash flow negative by approximately $10MM per month. The negative cash flow was caused by deals recently struck which required the hold back of revenue as the HMO paid claims on FPA's behalf. Doug acknowledged that this was a deviation from the stated strategy of pmpm cash payments in advance. Doug outlined the company's plan to fix the situation which included (i) renegotiation with Foundation and Pacificare; (ii) $25MM in SG&A cost cuts; and (iii) the raising of junior equity capital. The company would take through the weekend to finalize the numbers and determine if they would be in compliance at March 31. In the meantime the company borrowed the remaining $6MM in availability. We reviewed the request for a borrowing with Simpson Thacher, who advised us that the company had not notified us of a default, they had only notified us of the potential of a default and we were therefore obligated to advance the money.

During the next week we held several conference calls with management and the bank group to discuss how we would address the situation. We also called in BKB's Loan Review unit for consultation. On May 14 we received approval from the Required Lenders to provide the company

with a waiver of the covenant default through June 11. The June 11 date gave the banks another opportunity to exercise their rights before the $2.6MM sub debt interest payment due on June 15. As a condition of the Waiver the company agreed to deliver a week by week cash flow projection for the following six weeks, a monthly cash flow projection through the end of the year, an account receivable aging and a claims payable aging. The company also agreed that a consultant would be hired, at the company's expense, that would aid the bank group in analyzing the situation. The credit was downgraded from a CRR/FRR "5" to a "7".

On May 22, as required by the Waiver, the company delivered: (i) a six week cash flow projection; (ii) an account receivable summary; and (iii) an account payable and IBNR summary. The bank group had hired the consulting firm of Policano & Manzo to review the information produced. The cash flow projection indicated that the liquidity situation was severe and the company could run out of cash within the next two weeks. However, management was taking steps to ensure that there would be sufficient liquidity, including delaying payments where possible and obtaining accelerated capitation payments from several payors. Management indicated that the well publicized June 11 deadline was putting additional pressure on its liquidity because several payors were delaying capitation payments in fear that FPA would be unable to provide service after June 11. The credit was downgraded to a CRR/FRR "8" and the account was transferred to Loan Review.

Why has the company's financial condition declined so quickly and so dramatically?

Earnings were significantly less than what management and the company's audited financial statements represented. The company's very aggressive accounting made it appear that they were quickly integrating acquisitions and managing medical expenses when in fact the company was losing money on many of its contracts. The company appeared to be moderately leveraged based on its reported EBITDA when its true EBITDA was dramatically lower. Also, in an effort to show internal growth the company entered into contracts with payors that deviated from what they publicly described as their strategy. Many of these contracts allowed the payor to withhold revenue as it paid claims on FPA's behalf, putting pressure on the company's liquidity.

The company delayed raising junior capital while old management explored a leveraged recap and then new management delayed further as it analyzed its options. Meanwhile, the company continued to make acquisitions and used up its available liquidity to pay for them. By the time new management began the process for the high yield offering the liquidity situation had grown too severe.

When the company announced its first quarter results and severe liquidity situation, it was a major surprise to the market. The company had begun working with several private equity sponsors to raise capital, however, the market's reaction has slowed the process. Likewise, the company had begun working with several payors to renegotiate contracts that would provide liquidity to FPA, however, while agreements have been reached they have

not been finalized as the payors are waiting to ensure the continued viability of the company.

Several payors have begun to withhold payments to FPA as they are concerned that they could become liable for claims not paid by the company. This situation has further constrained liquidity and is leading to the quick deterioration of the company.

[Declaration of Amy K. Weinstock authenticating the Credit Comment as a business record of BankBoston, N.A., omitted in printing.]

STEVENS DECLARATION EXHIBIT 5
[Pages 2-3 omitted in printing.]

Preparer: [ ] [ ] SMB 11/19/97
Reviewer: VCB 11/20/97 JRH 11/22/97 DJH 11/24/97

Risk Factors Worksheet 1211 : 1/4

SUMMARY OF RISK FACTORS		
A Score	15	A SCORE TEST: Score of 26 or higher indicates a high risk (Small private companies, 36 or higher)
C Score	3	C SCORE TEST: Score of 21 or higher indicates poor ability to react to change (Small private companies, 41 or higher)
Z Score	0.68397	Score is less than 1.1; the organization is in danger of bankruptcy

As the client has scored a Z-Score below 1.1, we have appropriately classified this audit as having greater than normal risk, although such test is predominantly used for manufacturing clients.

FPA Medical Management '97
Period End: 12/31/97 6/18/98 10:11 AM (Carbon)

Confidential Treatment Requested by Deloitte & Touche LLP

* * *

Preparer: [ ] [ ] SMB 11/19/97
Reviewer: VCB 11/20/97 JRH 11/22/97 DJH 11/24/97

Risk Factors Worksheet 1211 : 4/4

DATA ENTRY:		Enter the type of organization: Public Manufacturing, Private Manufacturing OR Non-manufacturing
Company Type:	Non-manufacturing	
	$	
Current assets:	238,985,423	
Total assets:	650,435,248	
Current liabilities:	197,590,731	
Total Debt:	285,873,145	
Market Value of Equity/Book Value of Net Worth:	142,494,070	
Retained Earnings:	-80,924,217	
Sale:	723,848,010	
Income Before Tax:	-274,241	
Interest Expense:	14,668,150	

RATIOS:		
Net Current Assets/ Total Assets	6.4%	
Retained Earnings/Total Assets	012.4%	
Income Before Tax & Interest/Total Assets	2.2%	
Book Value of Net Worth/Total Debt	49.8%	
Sales/Total Assets	111.3%	
Z SCORE:	0.6840	Score is less than 1.1; the organization is in danger of bankruptcy

FPA Medical Management '97
Period End: 12/31/97 6/18/98 10:11 AM (Carbon)

Confidential Treatment Requested by Deloitte & Touche LLP

[Exhibits 2 and 3 omitted in printing but reproduced at pages 219a-236a of this appendix; Exhibits 4, 5, 6, 7, 8, 9, 10, and 11 omitted in printing.]

APPENDIX K
(DISTRICT COURT'S INDICTMENT OF STEVEN M. LASH IN *UNITED STATES V. LASH*)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA
FEBRUARY 2000 GRAND JURY

Criminal Case No. 02 CR 0366 J

UNITED STATES OF AMERICA, Plaintiff,
v. STEVEN MARK LASH, Defendant.

[Filed February 12, 2002]

INDICTMENT

Title 18, U.S.C., Secs. 1341 and 1346 – Mail Fraud; Title 18, U.S.C., Secs. 1343 and 1346 – Wire Fraud; Title 18, U.S.C., Sec. 2314 – Interstate Transportation in Scheme to Defraud; Title 18, U.S.C., Sec. 1344 – Bank Fraud; Title 18, U.S.C., Sec. 2 – Aiding and Abetting

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The grand jury charges:

ALLEGATIONS COMMON TO ALL COUNTS

1. At all times material to this Indictment, FPA Medical Management, Inc. (hereinafter "FPA") was a Delaware corporation, with its principal office in San Diego, California, which derived substantially all of its operating

income from payments for managed care medical services and for emergency department medical services.

2. Defendant STEVEN MARK LASH was Executive Vice President and Chief Financial Officer of FPA from September 1, 1994, until he was removed from the position of Chief Financial Officer on March 25, 1998, remaining as Executive Vice President of FPA until June 1998.

3. At all times material to this Indictment, BankBoston (now known as Fleet National Bank) was a financial institution, the deposits of which were insured under the Federal Deposit Insurance Act, which acted as the administrative bank for a group of financial institutions which extended loans, funds, and lines of credit to FPA.

Counts 1–19
(Wire Fraud)

1. Beginning on a date unknown to the grand jury, and continuing to and including July 31, 1998, in the Southern District of California, and elsewhere, defendant STEVEN MARK LASH, did knowingly devise and intend to devise a scheme to defraud and to obtain money and property by means of materially false and fraudulent pretenses, representations and promises, and the concealment of material facts, by depriving FPA Medical Management, Inc. (hereinafter "FPA"), and its shareholders, of their right to the honest services of the defendant, free from dishonesty, deceit, and self-dealing.

2. It was part of the scheme to defraud that defendant STEVEN MARK LASH:

(a) intentionally made materially false representations and omitted material facts concerning FPA's

financial condition and operations in FPA's Forms 8-K, 10-K and 10-Q, filed with the United States Securities and Exchange Commission ("SEC"), in FPA press releases, in FPA conference calls with investment bankers and Wall Street analysts, and in FPA communications with financial institutions which were or became lenders to FPA;

(b) intentionally reported fictitious earnings for FPA to the public, investment bankers and Wall Street analysts, and FPA's lenders;

(c) intentionally concealed from the public, investment bankers and Wall Street analysts, and FPA lenders the company's use of "cookie jar reserves" to create fictitious earnings;

(d) intentionally misrepresented to the public, investment bankers and Wall Street analysts, and FPA's lenders that businesses acquired by FPA had been successfully integrated into FPA, both operationally and for financial reporting purposes;

(e) intentionally concealed from the public, investment bankers and Wall Street analysts, and FPA's lenders material facts about FPA's liabilities;

(f) intentionally concealed material facts from FPA's auditors, Deloitte and Touche (hereinafter "D&T");

(g) intentionally concealed material facts from members of FPA's board of directors;

(h) intentionally misrepresented to the public, Wall Street analysts, FPA's lenders, FPA's auditors, and members of FPA's board of directors that FPA had positive cash flow from operations, exclusive of one-time costs associated with acquisitions;

(i) directed FPA employees to create false, fictitious, and misleading financial information and bookkeeping entries in order to inflate FPA's earnings artificially;

(j) made, and caused FPA employees to make, false statements to FPA lenders relating to loans, loan covenants, and lines of credit;

(k) personally obtained more than $1.4 million from the sale of FPA stock at prices kept artificially high by the defendant's false representations and material omissions in FPA's SEC filings, in FPA press releases, and in FPA conference calls with Wall Street analysts;

(l) obtained millions of dollars in FPA bonuses and FPA stock options on the basis of the foregoing false representations and material omissions;

(m) caused FPA shareholders who bought and held FPA stock in reliance on the foregoing false representations and material omissions to lose millions of dollars in FPA share value upon the disclosure of the company's true financial condition;

(n) caused FPA lenders to lose more than $300 million upon FPA's default on the loans and lines of credit obtained on the basis of the defendant's false representations and material omissions; and

(o) misappropriated and converted more than a hundred thousand dollars worth of FPA property to the defendant's personal use and benefit.

3. On or about the dates set forth below, in the Southern District of California, and elsewhere, defendant STEVEN MARK LASH, for the purpose of executing and

attempting to execute the aforementioned scheme to defraud and to obtain money and property by false and fraudulent pretenses, representations, and promises, and the concealment of material facts, did transmit and cause to be transmitted, in interstate and foreign commerce, by means of wire, radio, and television communication, the writings, signs, signals, pictures, and sounds set forth below.

COUNT	DATE	SENDER	RECEIVER	COMMUNICATION
1	2/27/97	FPA	Morgan Walke	Press release
2	3/31/97	FPA	SEC	Form 10-K405
3	4/29/97	FPA	SEC	Form 10-K405/A
4	4/30/97	FPA	Morgan Walke	Press release
5	4/30/97	FPA	Morgan Walke	Conference call
6	5/15/97	FPA	SEC	Form 10-Q
7	7/30/97	FPA	Morgan Walke	Press release
8	7/30/97	FPA	Morgan Walke	Conference call
9	7/30/97	Steven M. Lash	Jack Greenman	e-mail
10	7/31/97	Walter Marullo BankBoston	Steven M. Lash FPA	Letter re Credit Agreement
11	8/1/97	Steven M. Lash FPA	Walter Marullo BankBoston	Letter re Credit Agreement
12	8/14/97	FPA	SEC	Form 10-Q
13	10/30/97	FPA	Morgan Walke	Press release
14	11/15/97	FPA	SEC	Form 10-Q
15	1/8/98	FPA	Morgan Walke	Press release
16	3/6/98	FPA	Morgan Walke	Press release
17	3/6/98	FPA	Morgan Walke	Conference call

18	4/1/98	FPA	SEC	Form 10-K
19	4/2/98	Steven M. Lash	Jack Greenman	e-mail

All in violation of Title 18, United States Code, Sections 1343, 1346, and 2.

Counts 20–26
(Mail Fraud)

1. Paragraphs 1 and 2 of Counts 1-19 are realleged and incorporated here.

2. On or about the dates set forth below, in the Southern District of California, and elsewhere, defendant STEVEN MARK LASH, for the purpose of executing and attempting to execute the aforementioned scheme to defraud and to obtain money and property by false and fraudulent pretenses, representations, and promises, and the concealment of material facts, did cause to be placed in a United States post office or other authorized depository for mail matter, items to be delivered by the United States Postal Service according to the directions thereon, and caused to be deposited items to be sent and delivered by private and commercial interstate carriers, as set forth below.

COUNT	DATE	SENDER	RECEIVER	COMMUNICATION
20	3/10/97	William Gonzaba FPA/Gonzaba	Seth Flam FPA	Letter re FPA finances
21	10/1/97	MCI	FPA	Invoice
22	10/8/97	Amy Ploch FPA	Rich Reeves	FedEx re campaign contributions
23	10/14/97	American Airlines	FPA	Invoice for $300,630

24	12/5/97	Steven M. Lash FPA	Charles C. Woodard Bank Boston	Letter re FPA finances
25	3/1/98	MCI	FPA	Invoice
26	6/25/98	James Lebovitz FPA	Steven M. Lash	Letter re MCI credits

All in violation of Title 18, United States Code, Sections 1341, 1346, and 2.

Count 27
(Interstate Transportation in Scheme to Defraud)

On or about November 5, 1997, in the Southern District of California, and elsewhere, defendant STEVEN MARK LASH, having devised and intending to devise a scheme to defraud, did knowingly and for the purpose of executing the scheme, cause and induce representatives of BankBoston (now known as Fleet National Bank) and its associated financial institutions to travel in interstate commerce to San Diego, California, for a meeting with FPA Medical Management, Inc. (hereinafter "FPA") representatives concerning FPA's application for an extension and enlargement of a line of credit, loans, and other funds.

All in violation of Title 18, United States Code, Sections 2314 and 2.

Count 28
(Bank Fraud)

1. Beginning on a date unknown to the grand jury, and continuing to and including June 30, 1999, in the Southern District of California, and elsewhere, defendant STEVEN MARK LASH, did knowingly devise and intend to

devise a scheme to defraud BankBoston (now known as Fleet National Bank), a financial institution.

2. It was a part of the scheme to defraud that the defendant STEVEN MARK LASH:

(a) intentionally made materially false representations and omitted material facts concerning the financial condition and operations of FPA Medical Management, Inc. (hereinafter "FPA") in FPA's Forms 8-K, 10-K and 10-Q, filed with the United States Securities and Exchange Commission (hereinafter "SEC"), in FPA press releases, in FPA conference calls with investment bankers and Wall Street analysts, and in FPA communications with financial institutions which were or became lenders to FPA;

(b) intentionally reported fictitious earnings for FPA to the public, investment bankers and Wall Street analysts, and FPA's lenders;

(c) intentionally concealed from the public, investment bankers and Wall Street analysts, and FPA lenders the company's use of "cookie jar reserves" to create fictitious earnings;

(d) intentionally misrepresented to the public, investment bankers and Wall Street analysts, and FPA's lenders that businesses acquired by FPA had been successfully integrated into FPA, both operationally and for financial reporting purposes;

(e) intentionally concealed from the public, investment bankers and Wall Street analysts, and FPA's lenders material facts about FPA's liabilities;

(f) intentionally concealed material facts from FPA's auditors, Deloitte and Touche (hereinafter "D&T");

(g) intentionally concealed material facts from members of FPA's board of directors;

(h) intentionally misrepresented to the public, Wall Street analysts, FPA's lenders, FPA's auditors, and members of FPA's board of directors that FPA had positive cash flow from operations, exclusive of one-time costs associated with acquisitions;

(i) directed FPA employees to create false, fictitious, and misleading financial information and bookkeeping entries in order to inflate FPA's earnings artificially;

(j) made, and caused FPA employees to make, false statements to FPA lenders relating to loans, loan covenants, and lines of credit; and

(k) caused FPA lenders to lose more than $300 million upon FPA's default on the loans and lines of credit obtained on the basis of the defendants' false representations and material omissions; and;

3. On or about December 5, 1997 in the Southern District of California, and elsewhere, defendant STEVEN MARK LASH, knowingly executed and attempted to execute the aforementioned scheme to defraud by submitting to BankBoston, in support of FPA's request for an extension and enlargement of a line of credit, loans, and other funds, a letter which falsely stated that FPA was cash flow positive from operations exclusive of one-time costs associated with acquisitions.

All in violation of Title 18, United States Code, Sections 1344 and 2.

DATED: February 12, 2002.

A TRUE BILL:

/s/ Jose Reuben Santiago
Foreperson

PATRICK K. O'TOOLE
United States Attorney

/s/ Stephen P. Clark
STEPHEN P. CLARK
Assistant U.S. Attorney

/s/ Kevin J. Kelly
KEVIN J. KELLY
Assistant U.S. Attorney

APPENDIX L

(DISTRICT COURT'S NOTICE OF ORGANIZATIONAL VICTIMS IN *UNITED STATES V. LASH*)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Criminal Case No. 02CR0366H

UNITED STATES OF AMERICA, Plaintiff,
v. STEVEN MARK LASH, Defendant.

[Filed June 13, 2003]

NOTICE OF ORGANIZATIONAL VICTIMS PURSUANT TO FED. R. CRIM. PRO. 12.4

COMES NOW the plaintiff, UNITED STATES OF AMERICA, by and through its counsel, Carol C. Lam, United States Attorney, and Stephen P. Clark and Kevin J. Kelly, Assistant United States Attorneys, and hereby submits its Notice of Organizational Victims pursuant to Fed. R. Crim. P. 12.4(2), together with a list of such victims, attached hereto.

[Signatures omitted in printing.]

* * *

BankBoston, N.A.

* * *

Orange Coast Managed Care Services, Inc. (OCMCS)

* * *

St. Joseph Medical Corporation (SJMC)

* * *

APPENDIX M (DISTRICT COURT'S VERDICT OF CONVICTION IN *UNITED STATES V. LASH*)

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

Criminal Case No. 02CR0366-H

UNITED STATES OF AMERICA, Plaintiff,
v. STEVEN MARK LASH, Defendant.

[Filed October 22, 2003]

VERDICT

We, the jury in the above entitled cause, find the defendant, Steven Mark Lash,

_____ of wire fraud as charged in count 1, (2/27/97 FPA Morgan Walke press release)

_____ of wire fraud as charged in count 2, (3/31/97 FPA SEC Form 10-K405)

_____ of wire fraud as charged in count 3, (4/29/97 FPA SEC Form 10-K405/A)

_____ of wire fraud as charged in count 4, (4/30/97 FPA Morgan Walke Press release)

_____ of wire fraud as charged in count 5, (4/30/97 FPA Morgan Walke Conference call)

_____ of wire fraud as charged in count 6, (5/15/97 FPA SEC Form 10-Q)

_____ of wire fraud as charged in count 7, (7/30/97 FPA Morgan Walke Press release)

_____ of wire fraud as charged in count 8, (7/30/97 FPA Morgan Walke Conference call)

_____ of wire fraud as charged in count 9, (7/30/97 Steven M. Lash Jack Greenman email)

_____ of wire fraud as charged in count 10, (7/31/97 Walter Marullo Steven M. Lash letter re credit agreement)

_____ of wire fraud as charged in count 11, (8/1/97 Steven M. Lash Walter Marullo letter re Credit agreement)

_____ of wire fraud as charged in count 12, (8/14/97 FPA SEC Form 10-Q)

Guilty of wire fraud as charged in count 13, (10/30/97 FPA Morgan Walke Press release)

Guilty of wire fraud as charged in count 14, (11/15/97 FPA SEC Form 10-Q)

Guilty of wire fraud as charged in count 15, (1/8/98 FPA Morgan Walke Press release)

Guilty of wire fraud as charged in count 16, (3/6/98 FPA Morgan Walke Press release)

Guilty of wire fraud as charged in count 17, (3/6/98 FPA Morgan Walke Conference call)

Guilty of wire fraud as charged in count 18, (4/1/98 FPA SEC Form 10-K)

_____ of wire fraud as charged in count 19, (4/2/98 Steven M. Lash Jack Greenman email)

Not Guilty of mail fraud as charged in count 21, (10/1/97 MCI FPA Invoice)

Not Guilty of mail fraud as charged in count 23, (10/14/97 American Airlines FPA Invoice)

Guilty of mail fraud as charged in count 24, (12/5/97 Steven M. Lash Charles C. Woodard FPA BankBoston Letter re FPA finances)

Not Guilty of mail fraud as charged in count 25, (3/1/98 MCI FPA Invoice)

_____ of interstate transportation in scheme to defraud as charged in count 27,

Guilty of bank fraud as charged in count 28,

/s/ Mike Aguilar
FOREPERSON OF THE JURY

DATED: 10/22/, 2003
SAN DIEGO, CALIFORNIA

Supreme Court, U.S.
FILED
JUL 7 - 2005
OFFICE OF THE CLERK

(2)

No. 04-1636

In The

Supreme Court of the United States

CHARLES T. MADDEN, et al.,

Petitioners,

v.

DELOITTE & TOUCHE LLP,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR THE RESPONDENT IN OPPOSITION

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July 7, 2005

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QUESTIONS PRESENTED

1. Was the court of appeals correct in holding that in the light of undisputed evidence, alleged misstatements in a particular securities registration statement were immaterial as a matter of law?

2. Was the court of appeals correct in holding that in the light of undisputed evidence, the respondent in this action under Section 11 of the Securities Act of 1933 had established its affirmative defense of loss causation?

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BRIEF FOR THE RESPONDENT IN OPPOSITION

REASONS FOR DENYING THE PETITION

This case does not deserve this Court's attention. The Petition involves a single claim for relief, under Section 11 of the Securities Act of 1933. Respondent Deloitte & Touche LLP ("Deloitte"), a defendant below, won summary judgment in the district court on two independent grounds. Deloitte presented undisputed evidence that negated an element of the plaintiffs' claim (materiality) and established an affirmative defense (loss causation). The court of appeals affirmed the judgment in a unanimous and unpublished memorandum disposition that cannot be cited as precedent, and does not acknowledge, create, or reflect any conflict with the law of any other Circuit. Petitioners' arguments are meritless and are, at best, claims of mere error. This Court should devote its scarce resources to other matters.

Because this Court is not a court of errors, Petitioners argue that the disposition below creates two inter-circuit conflicts. Petitioners first argue that the court of appeals erred in assessing the *materiality* of the alleged misstatement in the securities registration statement by considering information in the public domain, but not reproduced within the four corners of the registration statement, as part of the "total mix of information" available. Petitioners further assert that there is a conflict among the circuits on this issue. There is, however, no division among the courts of appeals, and no court has ever recognized one. Some courts evaluating materiality have considered information reproduced in registration statements, while others have considered information otherwise in the public domain. This does not reflect a conflict of law; courts have simply been presented with differing evidence in different cases.

All courts apply the same general rule: an alleged misstatement is material only if it significantly alters the "total mix of information" available to investors. By definition, the "total mix of information" virtually always contains information outside the four corners of the registration statement. Petitioners also argue that the Ninth Circuit used an "arbitrary numerical benchmark" to determine materiality, and that this approach contradicts decisions by other circuits. That argument simply mischaracterizes the disposition below. The court of appeals used no numerical benchmark at all.

The court of appeals also held, as an independent ground for affirming summary judgment, that Deloitte had established its affirmative defense of loss causation. Petitioners assert that this conclusion is inconsistent with this Court's opinion last Term in *Dura Pharmaceuticals, Inc. v. Broudo.* Petitioners are mistaken. The court of appeals considered evidence that negated *both* aspects of loss causation discussed in *Dura.* Deloitte presented *unrebutted* expert testimony and other evidence showing *both* that the price Petitioners paid for their securities was not inflated by the alleged misstatement at issue (establishing, among other things, that the alleged misrepresentation was not material to investors) and *also* that "revelation" of true facts contradicting the alleged misstatement did not cause the subsequent decline in the price of those securities. If anything, *Dura* raises the bar for securities plaintiffs in the Ninth Circuit; it does *not* change the law in any way helpful to Petitioners.

A. The Court Of Appeals' Unpublished Disposition Does Not Create Or Reflect An Inter-Circuit Conflict Regarding The "Total Mix Of Information" Relevant For Assessing Materiality

Petitioners argue that there is a split between the Third, Fifth, and Seventh Circuits, on one hand, and the Eighth and Ninth Circuits, on the other hand, over what constitutes the "total mix of information" available to securities purchasers for purposes of assessing the materiality of an alleged misstatement. Petition at 12-19. No such split exists. The Third, Fifth, and Seventh Circuits, like the Ninth Circuit, agree that information in the public domain can render an alleged misstatement or omission immaterial as a matter of law.[1] *See Klein v. General Nutrition Cos., Inc.*, 186 F.3d 338, 342 (3d Cir. 1999) ("A determination of 'materiality' takes into account considerations as to the certainty of the information, *its availability in the public domain*, and the need for the information in light of cautionary statements being made.") (citing *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371-72 (3d Cir. 1993) (emphasis supplied); *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 214-16 (5th Cir. 2004) (*"The 'total mix' of information normally includes information that is and has been in the readily available general public domain and facts known or reasonably available to the shareholders."*) (emphasis supplied); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 512 (7th Cir. 1989)

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[1] The Eighth Circuit case cited by Petitioners, *Romine v. Acxiom Corp.*, 296 F.3d 701 (8th Cir. 2002), is simply a horse of a different color. The court of appeals' decision regarding materiality in that case turned on its conclusion that the alleged omission was *trivial*, not that it was already part of the total mix of information available to the plaintiffs. *See id.* at 708-09.

(holding that an alleged omission was not material because facts were reported in newspapers and by analysts who covered the industry). These cases, cited by Petitioners, demonstrate that the Ninth Circuit applied a correct and universally accepted rule when it considered information in the public domain part of the "total mix of information" relevant to determining the *materiality* of the alleged misstatement identified by Petitioners.

Petitioners' argument is not aided by either *Trump* or *Krim v. Banctexas Group, Inc.*, 989 F.2d 1435 (5th Cir. 1993). The primary question before those courts involved the bespeaks caution doctrine, "a corollary of materiality applicable only to forward-looking statements." *See In re ATI Techs. Inc. Sec. Litig.*, 216 F. Supp. 2d 418, 441 (E.D. Pa. 2002). While both the *Trump* and *Krim* courts based their holdings on information within the four corners of the challenged prospectuses, neither case suggests that courts may not look to information in the public domain as part of the general materiality test. In fact, later opinions by the Third and Fifth Circuits cite *Trump* for the proposition that a court evaluating materiality may consider information in the public domain. *Klein,* 186 F.3d at 371-72; *Kapps,* 379 F.3d at 215 & n.11 ("*Trump* does partially base its decision on public domain type considerations.").[2]

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[2] Petitioners are similarly incorrect when they assert that the courts of appeals have universally limited their "total mix of information" inquiries in cases brought under Section 12 of the Securities Act of 1933 and Section 14(a) of the Securities Exchange Act of 1934 to "information reasonably made available in the specific securities filing at issue." Petition at 14. For instance, in *United Paperworkers Int'l Union v. Int'l Paper Co.*, 985 F.2d 1190 (2d Cir. 1993), the Second Circuit held that in determining materiality under Section 14(a) a court "should not consider the proxy statement alone," and that "[t]he 'total

(Continued on following page)

Because the court of appeals' unpublished disposition does not create or reflect an inter-circuit conflict regarding the "total mix of information" that is relevant to materiality, this Court should deny the Petition.

B. The Court Of Appeals' Unpublished Disposition Does Not Create Or Reflect An Inter-Circuit Conflict Regarding The Use Of Numerical Thresholds For Determining Materiality

Petitioners also argue that the Ninth Circuit's disposition conflicts with the law of two other circuits because it "applied an arbitrary numerical benchmark for materiality." Petition at 23. But the court of appeals did not discuss numbers, nor did it suggest in any way that any quantitative threshold was even a factor, much less *the* factor, in its decision.[3] *See* Appendix to Petition at 4a. Because nothing in the court of appeals' unpublished disposition suggests that the court based its conclusion regarding materiality on a numerical threshold, the decision does not create or reflect an inter-circuit conflict on this issue.

Moreover, the district court's analysis was also in harmony with the law of every circuit. Though the district

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mix' of information may also include 'information already in the public domain and facts known or reasonably available to the shareholders.'" *Id.* at 1198-99.

[3] Instead, at page 23 of the Petition, Petitioners quote the district court's order and attribute that language to the court of appeals. This tactic is particularly inappropriate here, as review of the district court's order and judgment was *de novo*. Because a court reviewing a decision below can affirm on any ground supported by the law and the record, *Thigpen v. Roberts*, 468 U.S. 27, 30 (1984), even if the district court had relied solely upon an arbitrary numerical threshold, which it did not, this error could not be attributed to the court of appeals.

court did *mention* that the alleged misstatement "represents a mere 3.7% of total operating revenue," this was clearly and expressly only one factor among many that influenced the district court's decision. *See* Appendix to Petition at 18a-21a. The cases cited by Petitioners agree that courts may consider quantitative factors in context, as the district court did here. *See Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 164 (2d Cir. 2000) (citing *Parnes v. Gateway 2000, Inc.*, 122 F.3d 539 (8th Cir. 1997) and *Glassman v. Computervision Corp.*, 90 F.3d 617 (1st Cir. 1996)).[4]

C. The Court Of Appeals' Holding On Loss Causation Is Entirely Consistent With – Indeed, Compelled By – *Dura Pharmaceuticals, Inc. v. Broudo*

Petitioners also challenge the court of appeals' holding regarding Deloitte's affirmative defense of loss causation and argue that it is inconsistent with this Court's recent opinion in *Dura Pharmaceuticals, Inc. v. Broudo*, 125 S. Ct. 1627 (2005). Petitioners are wrong. *Dura* changed Ninth Circuit law in one way only. It rejected prior cases holding that a plaintiff suing under section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5

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[4] Petitioners also argue that the court of appeals "nullified the auditor's duty of due diligence," Petition at 19-22, but do not articulate how, even if this were true, this would create an inter-circuit split or otherwise constitutes more than a claim of error. In any event, due diligence is an affirmative defense to a claim under Section 11 of the Securities Act. 15 U.S.C. § 77k(e). Deloitte did not base its motion for summary judgment on this defense. Accordingly, this issue was not reached by the district court or the court of appeals. Petitioners' entire argument with respect to due diligence is irrelevant to the two independent grounds for the Ninth Circuit's disposition.

satisfied its burden of pleading loss causation merely by alleging that it paid a price that was *inflated* by the effects of an alleged misstatement. This Court held that such a plaintiff must also plead and prove a causal connection between the alleged misstatement and a subsequent *decline* in the security's price that resulted in economic loss. *Id.* at 1633-34.

From the *Dura* Court's holding that stock price inflation alone is not *sufficient* to establish loss causation, Petitioners seek to extract the principle that stock price inflation is not even *necessary* to prove a causal connection between the alleged misstatement and plaintiff's economic loss. Petitioners' syllogism is logically flawed and legally indefensible. The absence of price inflation at the time of the transaction defeats plaintiff's claim in at least two respects. First, it establishes that at the time of the initial transaction the alleged misrepresentation was not material, thus defeating an essential element of plaintiff's *prima facie* case. Second, it demonstrates that the subsequent lower stock price necessarily reflects, "not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events," *Dura* at 5, thus establishing the absence of loss causation.

In any event, Deloitte went beyond simply proving that the price Petitioners paid for their securities was not inflated by the alleged misstatement. As the court of appeals expressly recognized, Deloitte's unrebutted evidence (including the *only* expert testimony on causation) negated *both* of the aspects of loss causation discussed in *Dura*. *See* Appendix to Petition at 5a ("Undisputed expert testimony established that: (1) FPA's early 1988 [sic] stock price was not inflated by any misrepresentations regarding

guaranteed access fund payments; and (2) FPA's stock decrease after March 20, 1998, was not caused by revelations regarding guaranteed access-fund payments."). Deloitte's evidentiary showing clearly anticipated, and met, the *Dura* standard.[5]

It is disingenuous for Petitioners to argue that anything in *Dura* changed the legal landscape in a way that helps them. *Dura* confirmed that loss causation requires a causal connection between an alleged misrepresentation and a subsequent price decline. Deloitte proved, among other things, that no such connection existed in this case, and it did so with *unrebutted* evidence.

The Ninth Circuit's conclusion that Deloitte had established its affirmative defense of loss causation is fully consistent with *Dura* and raises no issue for review by this Court.

---

[5] Because both improper price inflation and a causal connection to a subsequent price decline are necessary aspects of loss causation, Deloitte could have supported its affirmative defense by negating just one of these aspects. However, Deloitte's unrebutted evidence negated both.

CONCLUSION

For these reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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July 7, 2005

(3)

No. 04-1636

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In The
Supreme Court of the United States

CHARLES T. MADDEN, et al.,

Petitioners,

v.

DELOITTE & TOUCHE LLP,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

REPLY BRIEF FOR PETITIONERS

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July 19, 2005

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I. The brief in opposition establishes that Circuit court interpretations of materiality under Section 11 conflict with precedents of this Court and the statutory text Congress enacted.

Respondent's brief highlights the importance of the first question presented: Whether purchasers in a registered securities offering establish the materiality of audit opinions that were false when the registration statement became effective if the total mix of information *made available in the registration statement* conceals the truth.

Respondent incorrectly argues that all Circuit courts would charge purchasers in a registered offering with constructive knowledge of information outside a registration statement that they can conceivably find if they already know where to look, without regard to the resources or sophistication that they would need to find the information and use it to determine that the auditor had made material misrepresentations to them.

Even if all Circuit courts actually held this view – which they do not – it cannot be reconciled with Section 11's plain language requiring an auditor to "prove[] that at the time of such acquisition [the purchaser] *knew of* such untruth or omission." 15 U.S.C. § 77k(a) (emphasis added); *see* Appendix to Petition ("App.") 44a. Respondent's brief never cites or correctly quotes either Section 11(a) or this Court's holding in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (emphasis added): materiality is established when "the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information *made available*." Both the opinions below and Respondent's brief truncate the italicized words. *See* App. 4a, 20a-21a; Brief in Opposition ("Opp."), *passim*. These crucial words reflect Congress's decision to assign to auditors like Respondent the duty to reasonably investigate and make available the true information to purchasers in a registered securities offering.

Respondent argues that the courts below could presume Petitioners knew that Respondent had materially misstated FPA's financial condition based on reports of financial analysts. But those reports were not part of the registration statement. Respondent offered no evidence that Petitioners had actual knowledge of these reports or that they were made *reasonably available* to Petitioners, in the news media or otherwise. None of the reports warned that FPA faced imminent bankruptcy or had a negative net worth. The courts below nonetheless gave greater legal significance to these reports, prepared by strangers to the transaction with no Securities Act duties, than to the audit certification that Section 11 required Respondent to issue after a diligent investigation for Petitioners' benefit.

The Circuit courts indeed conflict on this issue. Respondent admits that one line of cases "based their holdings on information within the four corners of the challenged prospectuses" *[sic]*. Opp. 4 (citing *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357 (3d Cir. 1993); *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435 (5th Cir. 1993)). The silence of these cases on information outside the registration statement confirms rather than contradicts their explicit holdings that only "the 'total mix' of information *the document* provided investors" can determine materiality. *Trump*, 7 F.3d at 371. Other cases limit the materiality inquiry to information "readily available" or "reasonably available" to investors, such as firm- or industry-specific "facts of life" that "newspapers report . . . regularly." *Kapps v. Torch Offshore, Inc.*, 379 F.3d 207, 214, 216 (5th Cir. 2004); *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 512 (7th Cir. 1989). But even these cases do not consider parties to the registration statement "free to make material misrepresentations" or omissions. *Kapps*, 379 F.2d at 213.

Contrary to Respondent's argument, both the decisions below and *Romine v. Acxiom Corp.*, 296 F.3d 701 (8th Cir. 2002) conflict with these authorities because they

permitted misrepresentations of specific financial information that investors could not find correctly stated anywhere else. In *Romine*, the plaintiffs alleged three distinct misrepresentations; Respondent cites only the discussion of the third allegation, which does not bear on the Circuit split because the truth appeared in a document explicitly incorporated by reference into the registration statement as allowed by Section 2(a)(8). *See Romine*, 296 F.3d at 708-09; *cf.* 15 U.S.C. § 77b(a)(8), quoted at App. 43a. The first misrepresentation at issue in *Romine* was an "undisclosed departure from GAAP" that misstated quarterly earnings in a registration statement; no document incorporated by reference corrected this omission. While conceding that an undisclosed departure from GAAP "almost certainly states a § 11 claim," the Eighth Circuit treated a *subsequent* corrective disclosure as disproving its materiality. *See* 296 F.3d at 703, 705-06. Purchasers in the earlier registered offering could not have known about the later corrective disclosure.

Furthermore, a recent published district court decision in a leading venue for securities cases held without qualification that Section 11 "do[es] not require disclosure of publicly available information." *Merritt v. Merrill Lynch & Co.*, 272 F.Supp.2d 243, 250-51 (S.D.N.Y. 2003). The SEC as *amicus curiae* is urging the Second Circuit to reverse this holding, which remains on appeal, as part of a trend that contradicts the text of the Securities Act and threatens to inhibit the SEC's own enforcement authority because it entirely fails to consider whether the information has sufficient public dissemination to render the omission from the actual securities filing not misleading.[1]

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[1] Brief of SEC at 1-2 & n.1, *Merritt v. Merrill Lynch & Co.*, No. 03-7978 (2d Cir. filed June 22, 2004), available at www.sec.gov/litigation/briefs/merritt.pdf; *see* Pet. 14 n.5, citing this brief. The conflict of *Merritt* with the Circuit decisions independently warrants certiorari on the important question presented because this Petition cannot await the Second Circuit's decision. ROBERT L. STERN ET AL., SUPREME COURT

(Continued on following page)

This conflict with the SEC's interpretation of the Securities Act warrants certiorari. *See Morton v. Ruiz*, 415 U.S. 199, 201-02 (1974).

The decision below, although not published in Federal Reporter, *is* published at 118 Fed.Appx. 150 (9th Cir. 2004) and Fed. Sec. L. Rep. (CCH) ¶ 93,095 (9th Cir. 2004), and contributes to the growing confusion on assessing materiality under Section 11. The Court should grant the Petition to correct this confusion in the lower courts.

A. The conflict between interpretations of materiality under Section 11 and other securities laws warrants certiorari to restore uniformity.

Respondent denies that Section 12 prospectus cases and Rule 14a-9 proxy statement cases uniformly consider only the contents of the securities filing to determine the total mix of information made available. But Respondent identifies only one case purportedly considering information outside the securities filing without restriction, *United Paperworkers Int'l Union v. International Paper Co.*, 985 F.2d 1190 (2d Cir. 1993). *See* Pet. 14 & n.4; Opp. 4-5 & n.2. That case contradicts Respondent's argument. In dictum, the *United Paperworkers* court allowed constructive knowledge only if the information is "widely reported in readily available media." *Id.* at 1199. In its holding, the court declared that "the mere presence in the media of sporadic news reports does not give shareholders sufficient notice that proxy solicitation statements *sent directly to them* by the company may be misleading." *Id.* (emphasis added). The court refused to impute constructive knowledge of eight news articles because they were too "few in number, narrow in focus, and remote in time"

PRACTICE 239 (8th ed. 2002) (citing *Gulf States Steel Co. v. United States*, 287 U.S. 32 (1932)); *see also id.* 238 ("The contrary voices of district courts obviously add to the confusion. . . .").

and "not published in the context of this proxy context," thus not "part of the total mix of information *reasonably available* to shareholders." *Id.* (emphasis added). The court founded its holding on this Court's admonition that "not every mixture with the true will neutralize the deceptive." *Id.* at 1198-99, quoting *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097 (1991). The contrast between the uniform decisional law under Section 12 and Rule 14a-9 and the confusion under Section 11 fully warrants certiorari to restore uniformity.

B. The auditor's duty of due diligence forms the core of the special protection that Section 11 provides to purchasers in a registered offering.

Respondent's argument fails to recognize "the special protection afforded to purchasers in a registered offering by the 1933 Act," a fundamental distinction between a Section 11 claim and a fraud-on-the-market class action. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 383 (1983). This special protection arises from the "stringent standard" Section 11 imposes on auditors to demonstrate due diligence in disclosing the true financial condition of the securities issuer to purchasers. *Id.* at 381-82. That duty requires the auditor to discover and disclose any material change since the last audit. *See* Pet. 20-21. Both this Court and Congress treat due diligence as mandatory and integral to the standard of liability under Section 11. H.R. REP. NO. 85, 73d Cong., 1st Sess. 9 (1933), cited in *Herman & MacLean, supra*, 459 U.S. at 381-82 & n.12.

Like the courts below, Respondent disregards the direct relation of the materiality inquiry to the due diligence duty, cavalierly treating that duty as optional. Opp. 6 n.4. If Respondent had discharged its duty, it would have provided Petitioners actual knowledge of FPA's true financial condition; constructive knowledge would not be at issue. By charging Petitioners rather than Respondent with constructive knowledge of the undisclosed changes in

FPA's financial condition, the courts below "nullif[ied] the purposes of this legislation." H.R. REP. NO. 85, *supra*, at 9-10.

The record makes this case especially suitable for the Court to consider how the auditor's due diligence relates to materiality. Despite claiming the record contains only "undisputed evidence" (Opp. 1), Respondent prepared no statement of the case, conceding the accuracy of Petitioners' statement. *See* SUP. CT. R. 15.2, 24.2. The record demonstrates that Respondent *actually knew* – or at least would have known upon any reasonable investigation as FPA's auditor – that FPA had falsely depicted its financial condition in the registration statement, which Respondent did *nothing at all* to investigate or verify, in violation of applicable auditing standards. FPA's stock price dramatically collapsed to zero when FPA exhausted its fictitious earning stream and announced that its true net worth was negative, discrediting Respondent's claim that Petitioners could learn from market information in the "public domain" of FPA's imminent demise. It defies belief that Petitioners would trade assets worth $40 million for stock in the functionally bankrupt FPA if Petitioners had known what Respondent knew. *See* Pet. 2-6.

The decisions below place no legal significance on the auditor certification Section 11 requires for the specific benefit of purchasers in a registered offering. These decisions revive the *caveat emptor* system that the Securities Act abolished.

C. The Circuits have split on deciding materiality as a matter of law with numerical benchmarks.

Respondent does not dispute the Circuit split on numerical benchmarks, which the SEC condemns. Instead, Respondent argues that the courts below permissibly "consider[ed] quantitative factors in context" rather than applying a benchmark. Opp. 5-6. Even if this argument

were true, the decisions below would violate this Court's holding that

> the ultimate determination of materiality. . . . requires delicate assessments of the inferences a "reasonable shareholder" would draw from a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment.

TSC, supra, 426 U.S. at 450 (footnote omitted).

II. The decision below conflicts directly with this Court's intervening decision in *Dura v. Broudo*.

Respondent's brief obfuscates the second question presented: Whether purchasers in a registered securities offering establish that the auditor's materially false audit opinions caused their losses when the company goes bankrupt because of financial conditions that the auditor knew or should have known when the registration statement became effective but failed to disclose.

Respondent misinterprets *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. ___, 125 S. Ct. 1627 (1995), which disapproved the Ninth Circuit's test for loss causation: "the misrepresentation (using language the Ninth Circuit used) 'touches upon' a later economic loss." *Id.* at 1632; *cf.* App. 22a. The "touches upon" test erred not because it made causation too easy to prove (as Respondent argues) but because it entirely severed the causation inquiry from the guidance of common-law tort principles, depriving courts of any reasoned standard for causation. *Id.* at 1631-33.

Dura concerned a situation patently absent here: securities purchasers who claimed they paid artificially inflated prices but could not plead or prove they suffered any loss thereafter. *Dura*, 125 S. Ct. at 1632-33. Contrary

to Respondent's argument, the record shows both price inflation at the time of Petitioners' investment and a nearly $40 million loss caused when "the relevant truth beg[an] to leak out." *Id.* at 1631. "The price set for an offering of securities is essentially a forecast. Price can be characterized as a present value calculation of the firm's future streams of earnings or dividends." *Glassman v. Computervision Corp.*, 90 F.3d 617, 626 (1st Cir. 1996). FPA's gross distortion of its earnings necessarily inflated its stock price.[2] Petitioners invested $40 million without knowing as Respondent did that FPA faced imminent bankruptcy; Petitioners lost virtually their entire investment "after the truth ma[de] its way into the market place." *Id.* at 1631-32. *Dura* requires nothing more.

The standardless "touches upon" test allowed the courts below to dismiss Petitioners' claims despite a nearly $40 million loss, sustained because they did not share Respondent's knowledge of FPA's imminent bankruptcy. The courts below applied a fraud-on-the-market measure of damages, defeating Section 11's purpose of permitting purchasers in a registered offering to rely on the registration statement. Congress could not have contemplated this nonstatutory measure of damages – first devised by statisticians in the 1980s – when it enacted Section 11 in 1933. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 246-247 & nn.24-26 (1988); *id.* at 250 & n.1, 253-54 & nn.4-5 (White, J., dissenting). This conflicts with both the text of Section

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[2] This was evidenced by the testimony of Petitioner's accounting expert as well as the documented knowledge of FPA's chief financial officer that disclosure of its earnings management would "virtually eliminate any hope of equity raising in the future" (App. 187a). Respondent's strategic choice to hire *two* accounting experts, devoting one to auditing issues and the other to loss causation, did not leave the latter's testimony unrebutted as Respondent argues (Opp. 7-8).

Respondent's argument also ignores that Section 11 did not require Petitioners to prove causation; it required *Respondent* to prove the *complete absence* of causation. 15 U.S.C. § 77k(e), quoted at App. 45a-46a.

11 and the Court's recent decision in *Dura*, and therefore warrants certiorari and reversal.

CONCLUSION

The decisions below reflect both a Circuit split and a stark conflict with this Court's precedents and the statutory text on determining materiality under Section 11. The decisions below conflict with this Court's intervening decision in *Dura v. Broudo* by depriving Petitioners of recovery for a $40 million loss directly attributable to the public realization of the issuer's imminent bankruptcy, which Respondent knew and failed to disclose. This Court should settle the two questions presented in the Petition to restore the special protection Congress intended Section 11 to provide to purchasers in registered securities offerings.

Petitioners therefore respectfully request this Court to grant the writ of certiorari.

Respectfully submitted,

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Supreme Court of the United States

CHARLES T. MADDEN, et al.,

Petitioners,

v.

DELOITTE & TOUCHE LLP,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITION FOR REHEARING

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PETITION FOR REHEARING

Petitioners respectfully move this Court for an order (1) vacating the denial of the Petition for a Writ of Certiorari, entered on October 3, 2005, and (2) granting that Petition. As grounds for this motion, Petitioners state the following:

Two events virtually coinciding with this Court's denial of the Petition warrant rehearing. First, this Court has granted certiorari in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit,* No. 04-1371, part of the coordinated litigation captioned *Merrill Lynch & Co. Research Reports Securities Litigation*. Another of the *Merrill Lynch* cases resulted in a published opinion in the Southern District of New York, the leading venue for securities actions, that addresses the first question presented in the Petition: whether information outside securities filings can excuse Securities Act liability for otherwise material misstatements or omissions, absent proof that the undisclosed information was actually known to investors or so widely disseminated that its omission was not materially misleading. Now on appeal to the Second Circuit, the *Merritt* opinion agrees with the Ninth Circuit's decision in the instant case but deepens an existing conflict with the Third and Fifth Circuits. Even if the Second Circuit reverses, as the SEC has urged in an *amicus curiae* brief, a published split of authority will remain unless this Court grants certiorari.

Second, the resolution of this question has become even more critically important since the American Institute of Certified Public Accountants released a controversial white paper for auditing firms to adopt as official policy for "due diligence" in merger transactions like

Petitioners' transaction. Under this white paper, auditors would refuse to disclose their knowledge of fraud, illegal acts, or misinformation by company management. Securities industry leaders have condemned the AICPA's white paper as part of a "disturbing trend of auditor withdrawal from the due diligence process."[1] These actions threaten not only investors in the securities issued under materially misstated registration statements, but also "the very vitality of our capital markets" because they undermine public confidence in auditor disclosures.[2] Respondent's actions in the instant case anticipated this same trend of auditors attempting to minimize or evade their disclosure duties under Section 11 of the Securities Act.

The instant case presents the best vehicle for resolving timely and critical issues of auditor liability under Section 11. The named Petitioners lost $40 million after Respondent misstated the issuer's financial condition and failed to disclose its knowledge that the securities issuer had fallen into grave danger of bankruptcy. Petitioners had no actual knowledge of the danger of bankruptcy, and no public domain information warned of any risk of bankruptcy. And yet the courts below held that analyst reports commenting on some aspects of the issuer's earnings

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[1] Letter from Micah S. Green, President and CEO, The Bond Market Association, and Marc E. Lackritz, President, Securities Industry Association, to Donald T. Nicolaisen, Chief Accountant, Securities & Exchange Commission, at 3 (Oct. 13, 2005) (available at www.sia.com/2005_comment_letters/8594.pdf).

[2] *See* Letter from the Financial Reporting Committee of the Association of the Bar of the City of New York to the Center for Public Company Audit Firms, American Institute of Certified Public Accountants, at 2 (Sept. 30, 2005) (available at www.nycbar.org/pdf/report/White_Paper_letter.pdf).

reporting but saying nothing of potential bankruptcy rendered immaterial Respondent's admitted misrepresentation of the issuer's financial condition.[3]

The Petition presents issues critical to the integrity of the national capital markets and the system of investor protection through full disclosure Congress implemented in the Securities Act of 1933. This Court should therefore vacate the denial of the Petition for a Writ of Certiorari and grant that Petition.

I. The Grant of Certiorari in *Merrill Lynch v. Dabit* Warrants Rehearing and Certiorari in the Instant Case.

On September 27, 2005, only six days before the denial of certiorari in the instant case, this Court granted certiorari in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit,* No. 04-1371,[4] on the question whether SLUSA[5] preempts certain state-law securities claims. *Dabit* is part of a series of 120 coordinated actions by stock purchasers and stock brokers challenging Merrill Lynch's allegedly biased investment advisory services.[6]

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[3] Although the developments discussed in this petition for rehearing most directly support review on the issue of materiality, they also support review on the issue of loss causation because the lower courts' improperly narrow materiality inquiry also caused them to view loss causation too narrowly. *See* Petition, at 27-29.

[4] 545 U.S. ___, 74 U.S.L.W. 3199.

[5] Securities Litigation Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227, codified at scattered sections of 15 U.S.C.

[6] *Dabit v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 395 F.3d 25, 29-30 (2d Cir. 2005), *cert. granted,* 545 U.S. ___, 74 U.S.L.W. 3199 (Sept. 27, 2005) (No. 04-1371).

The closely related case of *Merritt v. Merrill Lynch*,[7] cited in Petitioners' reply brief, remains pending on appeal before the Second Circuit. *Merritt* provides an answer to the first question presented by the Petition that deepens a Circuit-level conflict on how information outside a registration statement affects a Section 11 claim when it cannot be "proved," as Congress expressly required for a successful affirmative defense, that the purchaser "knew of such untruth or omission."[8]

In *Merritt*, research reports issued by Merrill Lynch on securities held by a Merrill Lynch mutual fund were affected by conflicts of interest. Merrill Lynch performed investment banking services for about one-third of the companies in the fund, and hoped to attract more investment banking business by issuing unjustifiably positive ratings on stocks their analysts actually considered poor. *Merritt* held that this information was "public knowledge" because of newspaper reports – none of them specific to Merrill Lynch, its mutual fund, or the securities at issue – describing the potential for conflicts of interest in the broker-dealer industry.[9]

This opinion from the leading securities venue deepens the Circuit-level conflict on information outside a misleading registration statement. The Third and Fifth Circuits look exclusively to "the 'total mix' of information

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[7] *Merritt v. Merrill Lynch & Co. (In re Merrill Lynch & Co. Research Reports Sec. Litig.)*, 272 F.Supp.2d 243 (S.D.N.Y. 2003); *see* Reply Br., at 3. The *Merritt* appeal was fully briefed by June 2004 and now awaits argument and decision. *Merritt v. Merrill Lynch & Co.*, No. 03-7978 (2d Cir.), docket as of Oct. 21, 2005.

[8] 15 U.S.C. § 77k(a).

[9] *Merritt v. Merrill Lynch*, 272 F.Supp.2d at 250-52 & n.7.

the document provided investors," except when information located outside the registration statement is indisputably "obvious" to a "reasonable investor," such as general economic conditions.[10]

The Seventh Circuit has taken a decidedly different tack, abandoning both the Congressionally mandated standard of actual knowledge for the "buyer's knowledge" affirmative defense and this Court's "reasonable investor" standard for determining materiality.[11] In *Wielgos v. Commonwealth Edison,* the Seventh Circuit excused an electric utility's indisputably inaccurate estimates of the time and expense required for licensing of its nuclear power plants "because professional analysts knew – although perhaps Wielgos did not – that Commonwealth Edison's estimates were biased." But the *Wielgos* court provided no evidentiary basis for what analysts purportedly knew and no legal basis for disregarding this Court's "reasonable investor" standard for materiality.[12]

The standard of the Third and Fifth Circuits, focusing on how a reasonable investor views the information actually contained in a registration statement, conflicts with the Seventh Circuit's standard of indulging inferences about what professional analysts might know.

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[10] *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 371, 377 (3d Cir. 1993) (emphasis added); *Krim v. BancTexas Group, Inc.*, 989 F.2d 1435, 1448 (5th Cir. 1993).

[11] *See* 15 U.S.C. § 77k(a) (buyer's knowledge defense); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (materiality).

[12] *Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 515 (7th Cir. 1989).

Both *Merritt* and the decisions below dramatically expand this Circuit conflict by dropping the only limiting factor of *Wielgos*. The Seventh Circuit recognized that a registration statement must always disclose "*firm-specific* information."[13] *Merritt* and the decisions below found no liability even when undisclosed information differed materially from industry-wide trends – even when, as in the instant case, Respondent alone knew that Petitioners' investment was most likely doomed to bankruptcy.

The *Merritt* case and the decision below demonstrate the continuing importance of this issue, splitting the Third, Fifth, and Seventh Circuits; no decision in the pending *Merritt* appeal can resolve the split. This Court should therefore grant the Petition.

II. Auditors Are Abandoning Their Obligation Under Section 11 to Ensure Full and Fair Financial Disclosure in Every Distribution of Securities.

The SEC has recognized that *Merritt* represents more than an isolated error. The SEC's *amicus curiae* brief urging reversal of *Merritt* identifies the case as part of a disturbing trend among participants in securities distributions to contend that materially misleading disclosures can be excused from both civil and administrative liability if the correct information could theoretically have been discovered by a highly sophisticated investor with unlimited

[13] *Id.* (italics original).

resources.[14] This Court should grant the Petition in the instant case because the trend represents an immediate threat to the SEC's enforcement authority as well as to public confidence in the nation's capital markets.

In early October, it became public that an AICPA committee chaired by Respondent's deputy chief executive had issued a draft white paper instructing its member auditors to refuse to disclose their knowledge of misinformation, illegal acts, or even outright fraud by company management in the "due diligence" process for securities distributions. Auditors would instead redirect such questions to the issuer's management.[15] As a leading financial journalist commented, that "may not help if they are the ones suspected of fraud."[16] Two leading trade associations, The Bond Market Association and the Securities Industry Association, along with the New York Bar's Financial Reporting Committee, have called on the AICPA to repudiate the white paper, saying it will put investors at risk as well as harming issuers by reducing public confidence in the transparency of the securities markets.[17]

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[14] Brief of SEC in *Merritt v. Merrill Lynch & Co.*, No. 03-7978 (2d Cir. filed June 22, 2004), at 2 & n.1 (available at www.sec.gov/litigation/briefs/merritt.pdf).

[15] American Institute of Certified Public Accountants, *Auditor Attendance at Due Diligence Meetings with Underwriters*, at 19 (Aug. 23, 2005) (available at www.nytimes.com/packages/pdf/business/20051006_NORRIS.pdf).

[16] Floyd Norris, *Are Auditors Not Doing Due Diligence?*, NEW YORK TIMES, Oct. 7, 2005, at B1.

[17] *See* Letter from Micah S. Green, *supra* note 1; Letter from Committee on Financial Reporting, *supra* note 2; Letter from Edward Forst, Chair, The Bond Market Association, and Daniel J. Ludeman, Chairman, Securities Industry Association, to Center for Public Company Audit Firms, American Institute of Certified Public Accountants, at 2-5

(Continued on following page)

Robert J. Kueppers, Respondent's deputy chief executive and head of the AICPA committee that produced the controversial white paper, claims that auditors' refusal to disclose their knowledge of fraud will not harm investors or the integrity of the securities markets "because no auditor would sign the required permissions for an underwriting to proceed if he or she had serious worries about fraud."[18] Yet in the case at bar, Respondent did exactly that. Respondent concealed its knowledge of the issuer's great risk of bankruptcy and of fictitious earnings reports that led to the conviction of the issuer's CFO for defrauding Petitioners and other investors.

This development demonstrates the importance of the issues presented by the Petition. Only a handful of audit firms review every publicly traded company. Those audit firms are abandoning their obligation to ensure full and fair financial disclosure as part of every distribution of securities. This Court should therefore grant the Petition.

III. This Court May Defer Deciding the Petition Pending Further Developments in *Merritt*.

In the interest of justice, this Court can exercise its power to defer decision on the petition for rehearing until the Second Circuit decides *Merritt*. In the *Ohio Power* case, this Court vacated an order denying a petition for

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(Oct. 6, 2005) (available at www.sia.com/2005_comment_letters/8683.pdf).

The Bond Market Association and the Securities Industry Association have frequently submitted *amicus curiae* briefs to this Court, most recently in *Merrill Lynch v. Dabit, supra*.

[18] Norris, *supra* note 16.

rehearing and ordered that "the petition for rehearing is continued."[19] Near the close of the next Term, the Court granted the continued petition for rehearing, vacated the denial of certiorari, granted the petition for certiorari, and summarily reversed the judgment below. In support of this procedure, the Court wrote: "We have consistently ruled that the interest in finality of litigation must yield where the interests of justice would make unfair the strict application of our rules."[20]

A published opinion by the Second Circuit on an issue striking the heart of the SEC's enforcement authority will very likely warrant a grant of certiorari. The denial of certiorari for Petitioners, triggered not by any lack of importance of the issues but most likely by the unpublished status of the Ninth Circuit's decision, will thwart the interest of justice and deprive this Court of the best vehicle for resolving the issues raised in *Merritt*. Respondent has only an attenuated interest in finality of this litigation since the judgment under review favored Respondent following seven years of complex litigation. Petitioners' enormous $40 million loss, undisputed by Respondent in this Court, establishes an interest of justice outweighing any immediate interest in finality.

Thus, if the Court lacks certainty of the appropriateness of certiorari at this time, it would best serve the

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[19] *United States v. Ohio Power Co.*, 351 U.S. 980, 980 (1956).

[20] *United States v. Ohio Power Co.*, 353 U.S. 98, 98, 99 (1957). The Court has also held petitions for rehearing for lengthy periods in the interest of justice. *See, e.g., Florida v. Rodriguez*, 461 U.S. 940 (1983) (petition for rehearing filed in 1981 and granted in 1983).

interest of justice to continue this petition for rehearing until the Second Circuit issues its decision in *Merritt*.

CONCLUSION

For the reasons set forth above, as well as those contained in the petition for writ of certiorari, Petitioners pray that this Court grant rehearing of the order of denial, vacate that order, grant the Petition for Certiorari on both questions presented, and review the judgment and opinion below.

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CERTIFICATE OF COUNSEL

As counsel for the Petitioners, I hereby certify that this petition for rehearing is presented in good faith and not for delay and is restricted to the grounds specified in Rule 44.2.

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